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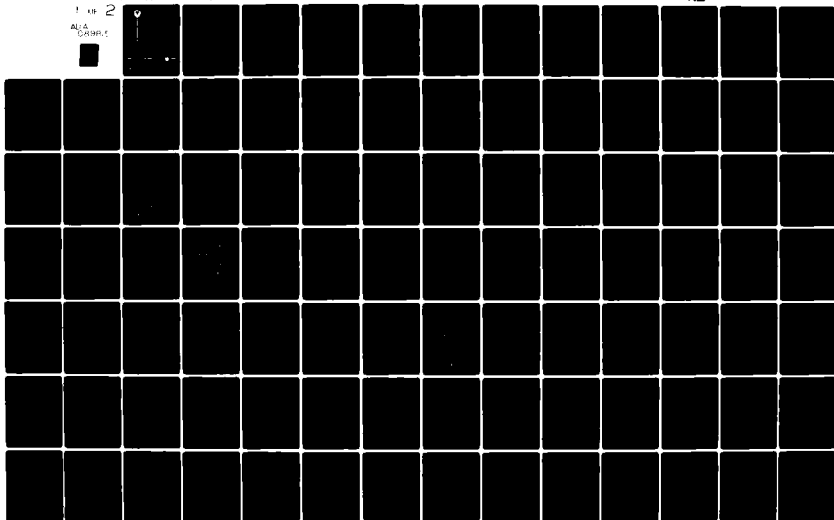
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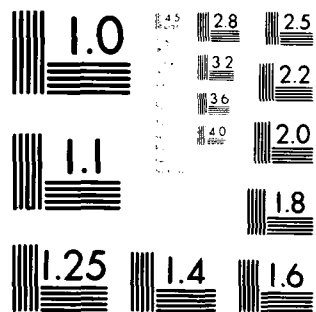
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SUBJECT: Army Procurement Research Office Report APRO 808, Detection
and Avoidance of Contractor Defaults

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Inclosed is a copy of subject report for your use. This study identifies indicators of impending defaults and contain recommendations on improved methodology for default detection. Procurement offices may find this study helpful in identifying acquisitions that have potential default problems and ways to resolve or minimize such problems.

FOR THE COMMANDANT:

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as

Paul F. Arvis
PAUL F. ARVIS, Ph.D.
Director, US Army
Procurement Research Office

25 September 1980

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DETECTION AND AVOIDANCE
OF
CONTRACTOR DEFAULTS

by

Duane D. Knittle

Daniel M. Carr

August 1980

Information and data contained in this document are based on input available at the time of preparation. Because the results may be subject to change, this document should not be construed to represent the official position of the US Army Materiel Development and Readiness Command unless so stated.

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EXECUTIVE SUMMARY

A. BACKGROUND. The "Default" clause provides the Government with the right to terminate a contract upon the occurrence of a performance failure. In order to determine if and when exercising this right is in the best interest of the Government, the contracting officer must have visibility of contractor performance. Failure to recognize and utilize indicators of performance difficulties constrains the contracting officer's decision making capabilities in this regard. This, in turn, may result in lost opportunities to pursue default terminations.

B. OBJECTIVES. The objectives of this study are to: (1) identify advance indicators of impending defaults; and (2) develop an improved methodology for default detection based on the systematic treatment of such indicators.

C. METHODOLOGY. The methodology employed to achieve these objectives includes: (1) a review of applicable legal or regulatory material; (2) the analysis of a broad sample of recent termination actions; and (3) interviews with individuals in both the contracting and legal disciplines.

D. CONCLUSIONS. Advance indicators of contractor defaults are manifest in various forms. These indicators can be categorized and incorporated into a system level model of the performance management process. Application of this model within DARCOM will enhance the contracting officer's ability to pursue and sustain default terminations in the most timely manner.

E. RECOMMENDATIONS. (1) Devote increased management attention to default detection and disposition; (2) Utilize the Prescriptive Model for Performance Management as a framework for the proper orientation of contracting personnel;

- (3) Improve methodologies for identifying apparent "buy-in" offers and marginally responsible offerors during the source selection process;
- (4) Establish a performance milestone tracking system to provide increased visibility of performance problems;
- (5) Implement a more objective approach for the settlement of excess reprourement costs prior to litigation.

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CHAPTER I

INTRODUCTION

A. BACKGROUND.

The "Default" clause for fixed price contracts provides the Government with the right to terminate a contract when faced with certain contractor performance failures. However, this right may be forfeited if a contracting officer fails to recognize available indicators of performance difficulties and to respond to these indicators in a timely and effective manner. Such failures can lead to undesirable outcomes, such as the conversion of a default termination to a termination for convenience, or the relaxation of material performance requirements without adequate consideration. This ultimately results in the expenditure of scarce funds without satisfactory benefit to the Government. The prompt identification and utilization of adverse indicators will improve the contracting officer's visibility of performance problems as they occur. Improved visibility will enhance his decision making capabilities, and, by extension, will improve his ability to initiate and sustain termination action when circumstances warrant.

In order to frame the discussion of termination for default as it applies to contracts under the cognizance of the US Army Materiel

Development and Readiness Command (DARCOM), it is first necessary to compare this concept with breach of contract under the Uniform Commercial Code (UCC). While the two are generally analogous, important differences do exist.

Breach of contract has been defined as the failure of one of the parties, without legal excuse, to perform any promise which forms the whole or part of the contract.¹ This definition is compatible with the "Default" provision set forth in the Defense Acquisition Regulations (DAR). However, that provision further refines the concept by delineating three specific contractor failures which constitute default under the purview of the clause:

- (1) Failure to make timely delivery;
- (2) Failure to make progress so as to endanger performance; or
- (3) Failure to perform any other provision of the contract.

The clause goes on to set forth the remedies available to the Government in the event of such a performance failure. First, the Government may terminate the whole or any part of the contract. Second, the Government may have the work completed at no additional cost to itself by repro-curing the terminated supplies or services against the defaulting contractor's account. Third, the clause reserves the Government's rights and remedies provided by law or under other provisions of the contract. Finally,

¹ Henry Campbell Black, Black's Law Dictionary, 4th ed. (St. Paul: West Publishing Co., 1968), p. 235.

it provides the contractor with the right to appeal a default termination in accordance with the "Disputes" clause of the contract.

A question arises as to the need for a special "Default" provision in Government contracts. In this regard, two important distinctions exist. First, the clause clearly and concisely defines the rights and remedies of the parties. More importantly, it provides the Government with the benefit of limiting the contractor's recovery if the Government improperly terminates for default. That is, if the contractor can show that a given default termination was improper, the company does not receive the common law remedy for buyer's breach. Rather, it obtains a settlement under the "Termination for Convenience" clause, which prohibits the recovery of anticipatory profits.²

Thus it can be seen that the Government has a rather pervasive right to pursue a termination for default and its attendant remedies. However, such action may not be in the best interest of the Government. Therefore, the DAR sets forth various options which are available in lieu of termination for default.³ These will be discussed in succeeding chapters. At this point, suffice to say that the determination as to whether to pursue a default termination is by no means cut and dried. It requires a thorough analysis of all factual data and available options, and the ultimate

²Government Contracts Program, Contract Administration (Washington: National Law Center, The George Washington University, 1976), pp 158-159.

³DAR 8-602.4.

decision rests with the informed judgment of the contracting officer. The subject to be addressed in succeeding chapters of this study is how this discretion can be exercised in the optimum manner and under the most favorable conditions.

B. STUDY OBJECTIVES.

The primary objectives of this study are to:

(1) Identify inherent characteristics and/or incipient behavior of DARCOM contractors which indicate a significant probability of subsequent default.

(2) Analyze current procedures for identification of and reaction to such default indicators, with particular emphasis on actions or inactions which may result in lost opportunities to pursue the various contractual remedies alluded to above.

(3) Recommend improvements which would provide increased visibility, optimize decision criteria, and protect all rights and remedies of the Government.

(4) Identify ancillary areas for further study.

C. DEFINITIONS.

Actual Default: Classic breach of contract, whereby the contractor fails to deliver the required supplies or to perform the required services within the time specified in the contractual document.

Expectant Default: Expected breach of contract whereby the contractor so fails to make progress as to endanger performance within the time specified.

Contract Strategy Formulation: The analysis of the requirements reflected in the procurement work directive in light of the present business environment, and the selection of a strategy designed to meet those requirements by establishing a contractual interface with the private sector.

Source Selection: The systematic evaluation of those acceptable offers received in response to a solicitation in order to identify the most advantageous alternative, and to verify the apparent ability of the firm offering that alternative to satisfactorily perform the contractual requirements.

Contract Management Application: The development of a Government surveillance and management plan, commensurate in detail with the criticality and probability of a performance failure as indicated at a given point in time. In this context, the terminology encompasses a broader set of functions than those normally associated with contract administration as performed by the Defense Contract Administration Services.

Default Disposition: The determination of the proper course of action to be pursued when confronted by an actual or expected performance failure.

Reprocurement Action: The acquisition of supplies or services substantially similar to those terminated in a manner which mitigates (i.e., minimizes) any damages to the defaulting contractor, and the assessment of any excess costs against that contractor's account.

D. SCOPE.

This study is primarily concerned with improving the ability of DARCOM contracting officers to recognize and utilize advance indicators of contractor default. It was initially assumed that such indicators would

surface only during contract performance. However, as research progressed, it became apparent that indicators of both the likelihood and mission impact of a subsequent default may also be present during the pre-award phases of a given action. Consequently, the scope of the project has been expanded to encompass a comprehensive examination of the entire acquisition process as it relates to default detection. A Prescriptive Model for Performance Management was ultimately developed in the context of five key decision points which are time phased throughout the acquisition cycle. Succeeding chapters systematically analyze the iterative decision making process which is reflected by this model.

It must be emphasized that the decision as to whether or not to exercise the contractual right to terminate for default ultimately be based on sound judgment. The contracting officer's exercise of discretion in this regard will be influenced by many considerations and constraints, depending on the situation at hand. Therefore, it is not the purpose of this report to prescribe a rigid course of action for universal application. Rather, it is intended to present a new methodology which will provide increased visibility in a more timely manner. Application of this methodology during various phases of the acquisition cycle will result in two primary benefits to the Army.

The most significant benefit to be derived is the ability to pursue and sustain terminations for failure to make progress. Contractual delivery schedules are assumed to reflect a legitimate need of the

requiring activity in fulfilling its assigned mission. By extension, it is also assumed that the failure of any contractor to perform within the time specified has the potential to impair mission capabilities to some degree. Recognition of the existence of a foregone failure and pursuit of a default termination in advance of actual delivery slippage will minimize the duration of mission impairment by expediting reprourement action.

A second benefit which will result from application of this methodology is the avoidance of waiver in pursuing terminations for failure to make timely delivery. As will be discussed in subsequent sections, the Government has a heavy burden of proof in sustaining a termination for failure to make progress. For this and other reasons, pursuit of an expectant default termination may not be feasible. If it is determined to defer action until a delivery failure occurs, the Government must be in a position to act within a reasonable period in order to avoid waiving its rights and remedies. Increased visibility during performance will provide for improved contingency planning and the ability to effect a default termination prior to occurrence of waiver.

As a final consideration in defining the scope of this study, it was decided to concentrate on the categories of expectant and actual default. While this constraint was not originally intended, these categories encompassed 58 of the 59 default terminations reviewed in the course of this research. Only one contract in the data base was terminated for failure to perform any other provision of the contract (in that case, failure to correct defects pursuant to the "Inspection" clause). However, the contracting

officer should be aware that there are numerous Standard DAR Provisions which explicitly provide for default termination. Examples include "Equal Opportunity Clause," "Covenant Against Contingent Fees," "Gratuities," and "First Article Approval." Furthermore, the right to terminate for default is implied in various other contract provisions. With regard to the treatment of such defaults, the procedures to be followed are the same as those required for expectant default.

E. METHODOLOGY.

Research for this study began with a thorough review of appropriate legal and regulatory material. Current literature in the subject area was also surveyed. While this effort provided valuable background knowledge, it was apparent that any substantive conclusions would have to be based on the analysis of actual termination actions. The methodology employed to identify such recently completed actions is detailed in succeeding paragraphs. In summary, a total of 59 default terminations, 23 convenience terminations and 13 no cost cancellations were ultimately reviewed. In addition, 52 individuals representing the procurement, legal and contract administration elements within DARCOM, the Department of the Army, Contract Appeals Division and the Defense Contract Administration Services (DCAS) were interviewed. This effort supplemented the case history analysis with a broad perspective of personal and organizational views of needed improvements.

With regard to establishing the data base of termination actions, it was determined at the onset to impose three constraints on candidates for review. First, in view of the fact that termination for default is a rare occurrence in cost reimbursable contracts,⁴ only fixed type instruments were targeted for review. Second, candidates were limited to actions taken by DARCOM Readiness Commands.⁵ This was done on the theory that those commands have the mission of acquiring fully developed items which would logically be contracted for on a fixed price basis. Finally, in order to insure currency of data, only actions which were taken from Fiscal Year (FY) 77 through the third quarter of FY 79 were considered.

⁴ This is primarily due to the fact that use of a cost reimbursable contract implies a mutual acknowledgement by the parties that a significant degree of uncertainty exists as to the outcome. Consequently, no finite baseline normally exists against which to gauge performance failure. Nonetheless, the DAR provides for the possible termination of a cost reimbursable contract for default in the clause entitled, "Termination" (DAR 7-203(a)). In the event of such termination, the contractor will be paid its allowable, allocable and reasonable cost, together with a fee which is proportionate to the total number of articles or amount of services delivered and accepted. No reprourement costs are assessed.

⁵ US Army Armament Materiel Readiness Command (ARRCOM); US Army Communication and Electronics Materiel Readiness Command (CERCOM); US Army Tank-Automotive Materiel Readiness Command (TARCOM); US Army Troop Support and Aviation Materiel Readiness Command (TSARCOM); and US Army Missile Materiel Readiness Command (MIRCOM).

Having thus established the parameters of the desired population, a computer program was developed to extract contractual actions meeting those criteria from the DARCOM data bank of Individual Procurement Action Reports (DD Forms 350). This step provided a listing of "Termination and Cancellation" actions taken by the Readiness Commands in FY 77 and 78, for a total of 181 initial candidates. Systematic sampling was applied to the initial candidates of two commands in order to minimize the administrative burden in the field; candidates from the remaining commands were included in total. This step reduced the target population to 117 actions. Letters were then generated to the commands which requested that they refine this raw data by providing the specific type of action taken (i.e., termination for default, termination for convenience, or no cost cancellation). The commands were also asked to identify any default terminations effected during the current fiscal year. The responses from the commands revealed seven input errors in the data base, thus reducing the DD Form 350 sample to 110 actions. However, an additional 78 actions surfaced as a result of command input and on-site research, for a total target population of 188 contracts.

Given the magnitude of this population, it was apparent that available personnel might not be able to analyze each action within the allotted time. Therefore, subcategories were prioritized for review as follows:⁶

⁶ For purposes of this study, a threshold of \$100,000 was established to differentiate between high and low dollar values.

Termination for Default

High Dollar Value

Low Dollar Value

Termination for Convenience

High Dollar Value

Low Dollar Value

No Cost Cancellations

Contract files could not be located for 40 candidates, and time constraints precluded review of the remaining 46 actions. Nevertheless, the 95 actions which were reviewed are considered to be representative of DARCOM termination experience. A review of the DD Form 350 printout indicated that these actions generally parallel the total population with regard to contract type, contract placement and business size. While only selected parameters were reflected in the printout, it provided a suitable vehicle to safeguard against inadvertant sampling bias.

Terminations for default were reviewed in depth to ascertain all relevant characteristics of the action from requirement generation through re-
procurement action.⁷ Terminations for convenience and no cost cancellations were reviewed for elements of contractor default and/or Government culpability. The objective of this effort was to determine the magnitude of

⁷ It should be noted that all desired data was not available for each action. For example, 17 notices of default terminations were reviewed in the Adversary Proceedings Division of the Office of Counsel. These notices were most helpful in documenting the post-award history of the contract in question. However, they provided no visibility of pre-award actions, and time did not permit recalling the contract files. Consequently, certain ratios presented in succeeding sections are based on varying denominators. Such instances are documented accordingly.

lost opportunities to pursue otherwise legitimate default terminations.

Taken as a whole, the data base of termination/cancellation actions, personnel interviews and literature sources is considered to represent a comprehensive spectrum of available information.

F. REPORT ORGANIZATION.

Chapter II introduces a Prescriptive Model for Performance Management. This model was developed during the data analysis phase of this research by analyzing command experience in conjunction with applicable regulations and current literature in the subject area. It represents a systematic methodology for information gathering and decision making at five key phases of the acquisition cycle. The first section of Chapter II presents a brief overview of the process. Succeeding sections discuss the factors which should be considered and actions which should be taken at each phase of the cycle. Chapter III examines the Contract Termination Experience of the DARCOM Readiness Commands in the context of this model. Current practices are compared with prescribed practices, thereby identifying the short-comings which presently exist. Chapter IV sets forth the conclusions drawn from this research. It includes certain recommendations for system level improvements, as well as recommendations applicable to selected phases of the process. Finally, opportunities for further study are identified.

CHAPTER II

PRESCRIPTIVE MODEL FOR PERFORMANCE MANAGEMENT

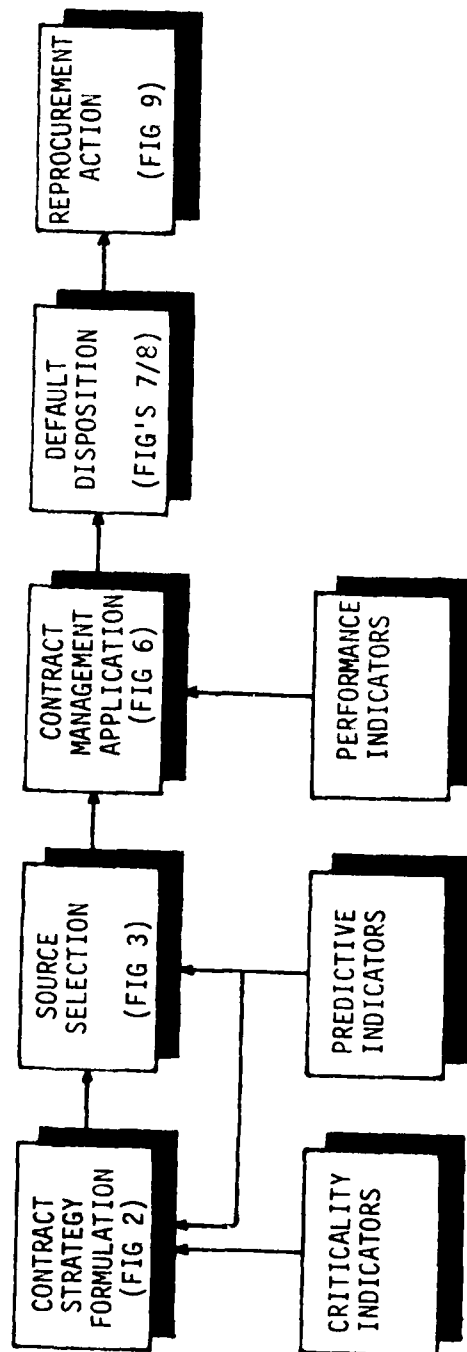
A. OVERVIEW.

1. The Prescriptive Model.

As research progressed on this project, the need for a structured view of the relationship which default termination bears to the entire performance management process became increasingly apparent. Questions arose such as: When do the root causes of performance failure first arise? How do they develop? What directions do they take? And how do these diverse causes interrelate? Consequently, the term "Performance Management" is used here in the "macro" sense, encompassing the entire process of decision making which begins with the receipt of a requirement document and ends with the completion of any necessary reprocurement action. Five sequential decision points have been identified that reflect the appropriate phases of this process for various actions to be taken. Figure 1 depicts these decision points in the context of a model which was developed to satisfy the need for a structured approach to performance management.

The model was derived in part from analysis of the termination experience data set forth in Chapter III of this report. However, it is presented at this point in order to establish a frame of reference for interpretation of the findings that follow. Taken as a whole, the model provides a

FIGURE 1
OVERVIEW OF PRESCRIPTIVE MODEL



systematic view of an iterative process of information gathering and decision making which places the subject of terminations for default in the proper management perspective. While certain substantive procedural changes would be required to fully effect the actions prescribed, every attempt has been made to utilize available management tools wherever possible. The model's primary value is to provide the proper orientation and direction for decision making in performance management.

2. Chapter Organization.

Each succeeding section addresses an individual decision point in depth, presenting the ideal operation of the model at that phase of the process. The section on Default Disposition has been subdivided to reflect the differing treatments accorded to expectant and actual defaults. A brief discussion of the practice of partial termination for default is also included. Each section prescribes factors which should be considered by the contracting officer and actions which should be taken to protect the Government's interests at that phase. Decision charts are included for each section which graphically depict the points covered by the narrative. A discussion of areas in which actual performance varies from the prescribed methodology is reserved for Chapter III of the report.

3. Assumptions.

It should be explained that a firm fixed price contract which was placed by means of either formal or small business restricted

advertising is assumed to be the normative situation.⁸ It is recognized that the preponderance of contract dollars are awarded as a result of negotiation. However, the DAR mandates a preference for formally advertised, firm fixed-price contracts. Socio-economic policies refine this preference to enhance small business participation. It is, therefore, assumed that it is intended to adhere to these regulatory guidelines, and that the tentative contract strategy reflects this intent. Any deviation from this normative strategy would result from the presence of one or more of the adverse indicators outlined below. Significantly, contracts placed in accordance with this strategy (i.e., formally advertised, fixed price contracts - particularly those awarded to small business contractors) exhibit the highest probability of a subsequent termination for default. This point will be analyzed in depth in Chapter III of this study.

B. CONTRACT STRATEGY FORMULATION.

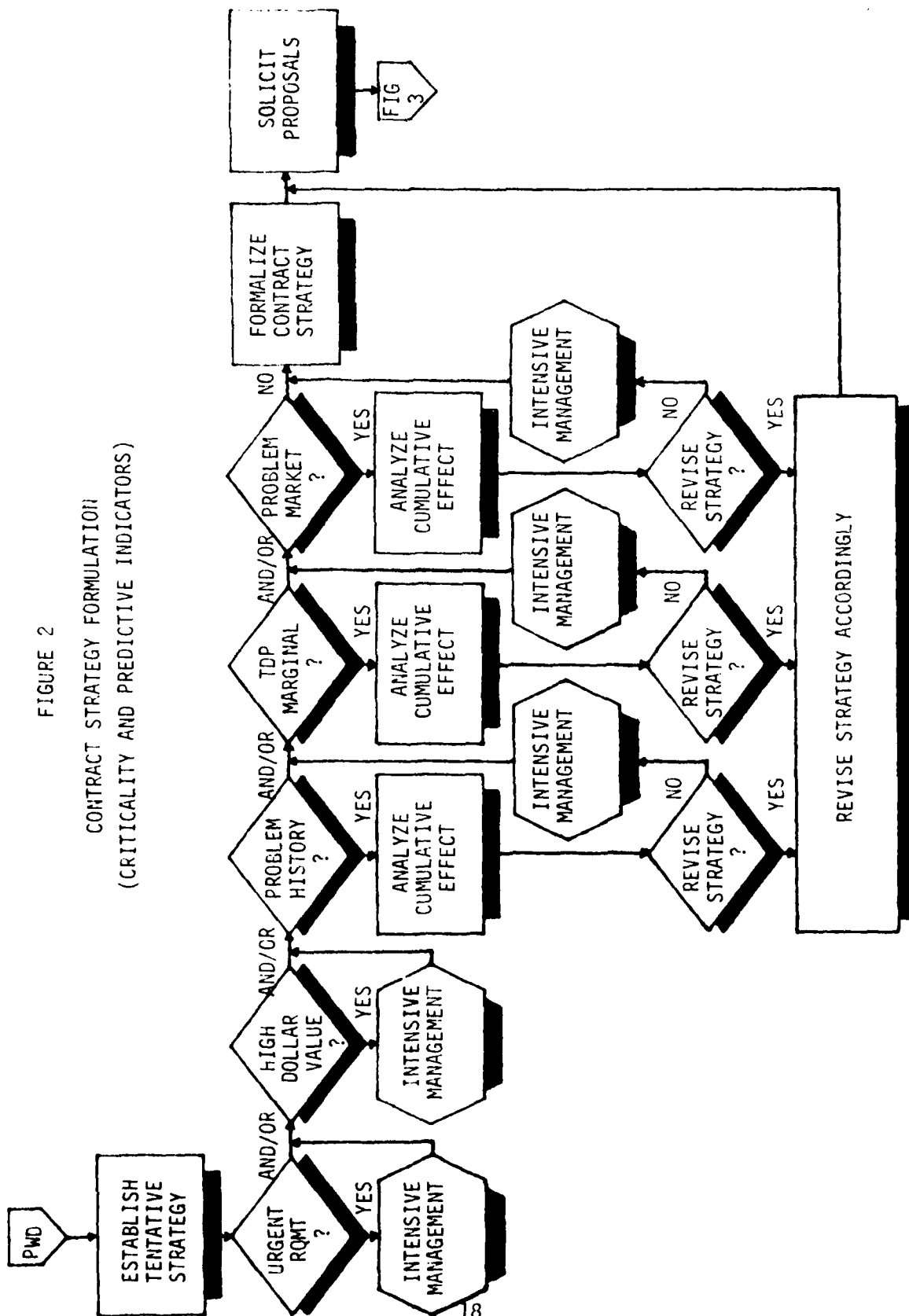
1. Introduction.

Certain decisions as to the level of visibility and manageability required during the life cycle of a contract must be made at the outset. The amount of information available at this stage is, admittedly, quite limited. Nevertheless, the contracting officer can gain certain basic insights as to the criticality of a potential default in terms of impaired mission capability and financial exposure. There may also be attendant

⁸ While small business restricted advertising restricts the available market by applying a special responsiveness requirement to formally advertised placement, the two methods are otherwise analogous.

historical, technical and/or environmental indicators which can serve as a rough predictive measure of such a failure. These have been identified as criticality indicators and predictive indicators, respectively. Their influences on Contract Strategy Formulation are illustrated by Figure 2.

In the extreme, the singular or combined effect of one or more of these indicators may render the advertised placement of a fixed price contract infeasible. For example, the urgency of a given requirement may dictate negotiated placement under the authority of DAR 3-202, Public Exigency. Or the combined effect of requirement urgency (a criticality indicator) and a history of problems related to specification inadequacies (a predictive indicator) may justify negotiation pursuant to DAR 3-210.2 (xiii), impossibility of drafting adequate specifications. If so, the contract strategy should be revised accordingly. In less extreme cases, the presence of one or more of these indicator(s) may not justify revising the contract strategy per se. However, in every case the presence of one or more of these indicators should alert the contracting officer to prepare for application of intensive management techniques during performance. The following paragraphs develop this theme by identifying some prevalent indicators and prescribing actions to be taken upon their occurrence.



2. Criticality Indicators.

Upon receipt of a procurement request, the contracting officer should first examine the urgency of the requirement and the estimated dollar value of the contract. Together, these factors determine the criticality of a possible default. They can also serve as the baseline for analyzing the cost effectiveness of intensive management application.

With regard to requirement urgency, the primary source of information set forth in the procurement work directive is the Criticality Designator assigned. Having identified the Designator assigned to the acquisition (A, B, or C), its propriety should be verified in light of the criteria set forth in DAR 25-103. This is particularly important in that the Criticality Designator reflected on the contract will be one of the primary factors considered by DCAS in assigning it to a given production surveillance category. It should similarly serve as a basis for determining the degree of internal monitoring which will be required. Thus, the proper assignment and analysis of the Criticality Designator can serve as the initial prioritization of requirements for subsequent application of intensive management techniques. That is, if Criticality Designator "A" is verified as being applicable to the requirement, it should be assumed that intensive management will be required. If Designator "B" is applicable, further investigation may be required to determine the severity of the potential impact on the affected production of repair line. The degree of intensive

management required will be in direct proportion to the potential impact identified. Those requirements reflecting Designator "C" should be candidates for exception management in the absence of significant overriding considerations.

Concurrently with the examination of the Criticality Designator, the estimated amount of the action should be considered. A high dollar estimate may be sufficient in itself to warrant the application of intensive management techniques. This is particularly true if it is intended to incorporate a progress payment provision into the contract, as its inclusion significantly increases the Government's financial exposure in the event of default. The degree of exposure is commensurate with the magnitude of the effort and its attendant price, due to the fact that the amount of progress payments will be based on costs incurred.⁹ However, it is the combined effect of dollar magnitude and requirement urgency which is most significant in projecting default criticality.

It must be recognized that the ultimate application of intensive management results in additional administrative costs to the Government. The amount of such expense varies directly with the level of resources applied. The benefit to be derived from the utilization of these scarce resources

⁹ In this context, it should be noted that while the inclusion of a progress payment provision increases the Government's financial exposure in the event of default, it also serves as a contractual vehicle for both financial and progress monitoring. In addition, the presence of a progress payment provision is another criteria used by DCAS to determine if an increased level of production surveillance is warranted.

is a function of the combined effect of urgency and amount. Thus, the denominator of a cost effectiveness analysis can be estimated with reasonable accuracy at the outset. By utilizing this information, the decision-maker can project the marginal value of resource commitment. It must be emphasized that this is an iterative process. At each decision point, the contracting officer must be satisfied that the marginal benefit of committing additional resources outweighs the marginal cost of such a commitment.

3. Predictive Indicators.

Having established the criticality of a potential default, the contracting officer should turn to the likelihood of such an occurrence. It is again emphasized that only a limited amount of information is available for projection purposes at this point. Tentative predictions can be made, but assumptions must be challenged and reverified as the action progresses through the Source Selection and Contract Management Application phases, in light of increased visibility.

In forecasting the probability of performance difficulties which may lead to an ultimate default, the contracting officer should initially review the purchase history of the item in question. It should be determined if the item has been acquired by means of price competition in the past.¹⁰ If not, the current action should become a candidate for intensive

¹⁰ The terms "price competition" and "price competitive strategy" are used throughout this report as generic terms to encompass both formal advertising and small business restricted advertising.

management in view of the unproven feasibility of such a strategy. If price competition has been employed on previous buys, the results of that strategy in obtaining satisfactory performance should be analyzed. The incidence of terminations for default on previous contracts is, of course, an obvious indicator of potential problems on the present action. Terminations in lieu of default (i.e., no cost cancellations or terminations for convenience reflecting some element of contractor default) should also be scrutinized. Finally, indications of unsatisfactory results may be reflected in the number of waivers granted, the number of deviations granted, the number of schedule extensions negotiated, or the number of months of schedule delinquency.

A poor performance record under prior contracts should, in itself, serve as a basis for application of intensive management techniques to the instant action. However, a high incidence of historical difficulties should also trigger a thorough investigation of the specific nature of such difficulties. That is, a poor performance history should be viewed as a symptom of a more basic problem. In order to isolate the causes, underlying such previous difficulties, the contracting officer must analyze the adequacy of the technical data package and the nature of the available market.

Specification adequacy is of paramount importance in a fixed price environment, due to the fact that the Government impliedly warrants that strict adherence will result in a satisfactory product. In short, the

responsibility for any specification deficiency is allocated to the Government. Inadequacies in the technical data package may lead to claims for equitable adjustments during performance. In the extreme, such deficiencies may render performance either "actually" or "practically" impossible. Actual impossibility exists when the contract cannot be performed in accordance with its terms, either by the instant contractor or by any other party.

In the absence of actual impossibility, the contractor may be able to demonstrate the contractual requirements are impracticable because of the extreme and unreasonable difficulty, expense, injury or loss involved in meeting them. This is the doctrine of practical impossibility. In order for a contractor to support a claim of practical impossibility, it must be established that the work is not possible within the basic contractual objectives contemplated by the parties, and that the cost and difficulty associated with accomplishing the work renders completion commercially senseless.¹¹ The essential point is that by demonstrating the existence of

¹¹ Government Contracts Program, pp. 61-67.

either form of impossibility, the contractor establishes an excuse for its failure to perform. If this occurs, the Government will not be able to sustain a default termination.

In view of the above, the contracting officer must be satisfied that the specifications are adequate and definitive before a price competitive strategy is employed. While the contracting officer does not generate specification requirements, he is obliged to point out any known deficiencies to the initiating activity. He should then work with that group to correct the inadequacy. As previously noted, historic performance problems may be good indicators of current deficiencies in the technical data package. The contracting officer's own technical background may facilitate independent review. Whatever the source of concern, there must be no hesitation to surface the suspected problem.

If major deficiencies or inaccuracies are discovered, the acquisition should be deferred pending correction, or consideration should be given to negotiated placement under the authority of DAR 3-210. However, relatively minor problems may not justify delaying the solicitation or resorting to negotiation. The contracting officer must exercise sound judgment in determining if the risk attendant in proceeding without correction is acceptable. If so, intensive management should be applied accordingly.

A final consideration which should be addressed in formulating a contract strategy is the market to be exploited. In order to implement a

price competitive strategy, at least two qualified sources which are willing to compete for the award must be available. However, the contracting officer should look beyond this minimum requirement. Once again, an historical perspective is of value in gauging the ability of potential competitors to satisfy the present requirement. However, the current condition of the market should also be scrutinized. Market stability is an important factor to consider. In a closely related area, the relationships among the various firms and the competitive status of the industry should be addressed. In this regard, it is generally assumed that the presence of full and free competition will insure price reasonableness. Notwithstanding this conventional wisdom, dealing with a depressed market may result in over zealous competition with attendant "buy-in" proposals.¹² This possibility, particularly when coupled with thinly capitalized producers, can be a significant indicator of performance failure. The actual presence of a "buy-in" offer is, of course, not discernable at this stage of the process. However, a history of "buying in" on the item in question or signs of industry depression at the present time, should be noted for contingency planning purposes.

As a final consideration of market analysis, the contracting officer should determine the probable size of the firms which will compete for the contract. While socio-economic policies mandate a preference for contracting with small businesses, it must be recognized that a disproportionate

¹²

A "buy-in" proposal is defined as an offer to perform at a price which is significantly lower than the anticipated cost of the contract.

number of default terminations involved small firms.¹³ Therefore, it is important for a variety of reasons to determine the likelihood of contracting with a small business at the outset. First, the command may initially intend to set aside a given requirement exclusively for small business participation. However, recognition of the increased risk of performance failure attendant to small business contracting may serve to override this decision for a relatively urgent requirement. Small business participation cannot (and should not) be precluded, but requirement criticality may dictate opening the competition to include lower risk producers. Second, if a small business award appears likely, more liberal contractor financing arrangements can be included in the solicitation with the objective of improving the small business contractor's cash flow posture. While this action increases the Government's financial exposure in the event of a default, it may also be the very action which prevents that default. The central point of this discussion is that it is of no benefit to either party to enter into a contract with a small business which places undue risk of failure on the firm. However, if it appears that a small business will obtain the contract, the contracting officer should be alerted to the probable need for intensive management during performance. This will insure that the Government's interests are fully protected, while at the same time

¹³ Evidence in support of this assertion, together with possible explanations therefore, are set forth in Chapter III of this report.

making certain that all obligations to the contractor are fulfilled in a timely manner. If performance problems do surface, all contractually authorized assistance can be provided to facilitate recovery. On the other hand, if performance failure appears to be unavoidable, proper steps can be taken to pursue and sustain a default termination. In sum, recognition of the increased risks of small business contracting is an important aspect of contingency planning.

For ease of reference, the various criticality and predictive indicators discussed above have been condensed into the following checklist. Similar checklists will be included in succeeding sections on Source Selection and Contract Management Application. A comprehensive tabulation of all adverse indicators reflected in these checklists is provided as Appendix A to this study.

CHECKLIST FOR CRITICALITY AND PREDICTIVE INDICATORS AT CONTRACT STRATEGY FORMULATION

I. CRITICALITY INDICATORS

A. Criticality Designator

·A

·B

·C

B. Dollar Value

•High _____

•Low _____

II. PREDICTIVE INDICATORS

A. Purchase History

•First Price Competition _____

•Previous Terminations for Default _____

•Previous Terminations in Lieu of Default _____

•Previous Delinquencies _____

•Previous Schedule Extensions _____

B. Technical Data Package

•Previous Requests for Waivers or Deviations _____

•Patent Inadequacies _____

C. Market Conditions

•Previous "Buy-Ins" _____

•Current Instability _____

•Current Noncompetitive Status _____

•Current Recession/Depression _____

4. Prescribed Actions.

It is recognized that the above considerations are not all encompassing. Additional information which is peculiar to a given acquisition

may be available to supplement the basic model. The point is that by assimilating all available information, the contracting officer can logically prepare to apply a level of management which is commensurate with the criticality of the requirement and the risk of performance failure. Such information serves as a foundation for decision making during successive stages of the cycle. However, it can also be used as a basis for definite actions during the pre-solicitation phase.

As noted above, the contracting officer's analysis may result in a determination to defer the acquisition pending resolution of technical data package inadequacies. It may result in a decision that negotiated placement of a flexibly priced contract is justified under regulatory guidelines. However, this type of decision making is inherent in sound contract formation and is considered to be beyond the scope of this study. It will, therefore, be assumed that the results of the analysis give rise to some degree of concern as to the successful outcome of a price competitive strategy, but do not require a drastic revision to the original contracting plan. In this case, three actions should be considered by the contracting officer.

First, consideration should be given to incorporating certain general and/or special provisions into the solicitation. For example, requirement urgency should alert the contracting officer to include Production Progress Report (DAR 7-104.51) and Notice to the Government of Labor Disputes (DAR 7-104.4). It may also be appropriate to incorporate one or more special

provisions in order to enhance performance visibility, such as contractually enforceable pre-delivery milestones in Section F of the schedule. This technique is used extensively in construction contracts and has been applied with some success within DARCOM.¹⁴ On the surface, these appear to be rather minor details of contract draftsmanship. However, in a competitive environment such reporting requirements should be determined prior to the issuance of the solicitation. At this stage competitive pressures will insure acceptance of such provisions by the offerors, whereas attempts at incorporation by supplemental agreement during performance may meet with resistance.

Second, in accordance with DAR 1-903.3, inclusion of special responsibility requirements may be appropriate. The contracting officer may determine that specialized experience or facilities are required. The urgency of the requirement may dictate restricting the market to firms which qualify for first article waiver. This technique, of course, cannot be used to unduly restrict competition. However, it can serve the legitimate function of assuring that only fully qualified firms are considered for award. This, of course, works to the mutual benefit of the Government and the potential competitors.

¹⁴ It must be recognized that application of either of these techniques requires verification of the contractor's reported progress. This can place a heavy burden on DCAS personnel.

Finally, and perhaps most importantly, early coordination with other interested functional elements should be effected. This will facilitate comprehensive contingency planning at the outset. A tentative surveillance plan can be formulated, and the ability to take expeditious action in response to adverse future developments will be enhanced. In selected cases, it may be advisable to convene a control board composed of contracting, technical, requirements and legal representatives. Such item-paced control boards will provide a forum for coordinated management throughout the life of the acquisition.

It is obvious that, like the amount of information available, the types of action which can be taken to protect the Government's interest in the event of default are rather limited during the Contract Strategy Formulation stage. However, perhaps the greatest benefit of early analysis of default probability and criticality is to alert the contracting officer to continually scrutinize developments during later stages of the acquisition cycle. While no contracting officer wishes to proceed with an acquisition with undue pessimism as to the outcome, the results of undue optimism can be far more injurious. Thorough analysis of factual data at the outset can result in the proper balance: objective realism.

C. SOURCE SELECTION.

1. Bid Responsiveness.

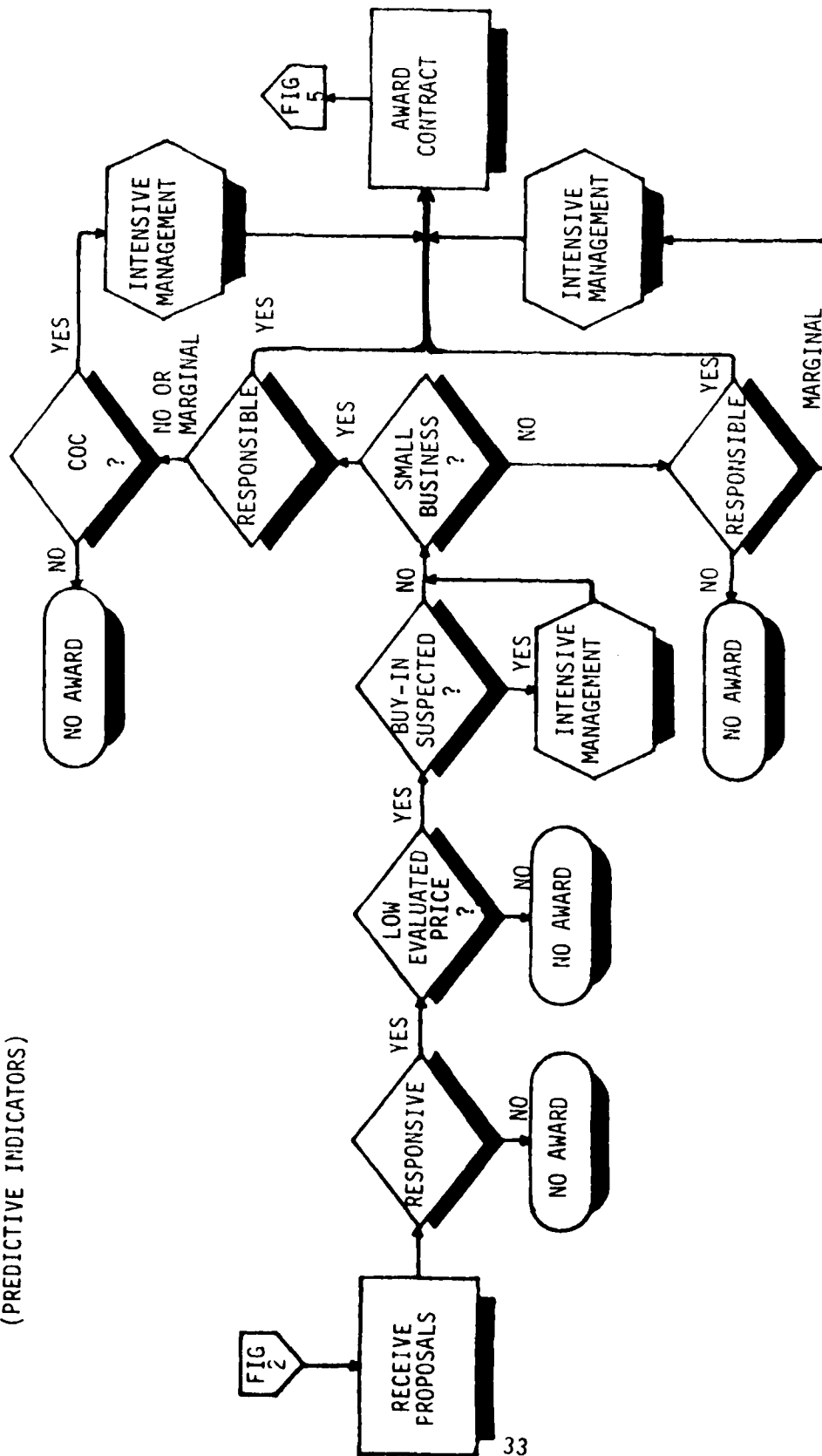
A price competitive acquisition contemplates award of a contract to the responsible firm which submits the lowest responsive offer. In order

to be responsive, the offer must be in exact accord with all material requirements of the solicitation and must be submitted in a timely manner. It must represent an unqualified offer to perform in accordance with all material terms set forth in the solicitation. Upon receipt of proposals, this is the first determination which is made by the contracting officer. By its nature, this is a rather objective selection procedure and has little bearing on default visibility. The remaining decisions in the source selection process (i.e., evaluation of the lowest price offered and determination of responsibility), however, can and do have a direct influence on the probability of subsequent contractor default. Figure 3 depicts the effect of these Source Selection decisions on performance management.

2. Bid Evaluation.

Having selected those bids which are responsive to the solicitation requirements, the contracting officer must next evaluate the offers to determine the lowest overall price. This process may reveal the first adverse indicator which specifically reflects on a given contractor's ability to perform (i.e., the first contractor-paced predictive indicator). As noted in the preceding section, one of the central principles of a price competitive strategy is the assumption that market pressures will assure a fair and reasonable price. That is, the perception of competition will motivate offerors to eliminate overpricing and to submit a bid which includes all costs of efficient production plus a reasonable profit.

FIGURE 3
SOURCE SELECTION
(PREDICTIVE INDICATORS)



This, of course, is the desired end. However, in certain situations competitive pressures can produce a much less desirable end: the "buy-in" offer. As discussed in the preceding section, buying-in can result from overzealous competition for limited business opportunities in a depressed industry. However, the practice can also result from an individual firm attempting to establish, maintain or expand its own market share within the industry by offering unrealistically low prices. The contracting officer must always be alert for this possibility - particularly if the market analysis performed during Contract Strategy Formulation indicated a high probability of such an occurrence. The reason is readily apparent. If the "buy-in" contractor is unable to increase the original price by overpricing contractual changes, it is faced with a loss contract. If the contractor's financial posture is such that the firm cannot absorb such a loss, bankruptcy may ensue. This, in turn, can result in the company's defaulting on its contractual obligation.

While DAR 2-404.2(e) calls for the rejection of any bid which the contracting officer determines to be unreasonable, the Comptroller General has held that so long as the bid of a suspected "buy-in" bidder is low and is responsive to the solicitation requirements, and the bidder is determined to be responsible, award must be made to that bidder.¹⁵ In effect,

¹⁵

53 Comptroller General 509 (1974); B-179835.

the contracting officer is precluded from rejecting a bid simply because it appears to be unreasonably low. However, such a bid may reflect a lack of understanding of the solicitation requirements, thereby bringing the offeror's responsibility into question. The contracting officer should, therefore, closely scrutinize such an offeror's technical, managerial, and financial capabilities at the time of the responsibility determination. The company's financial capacity to absorb the indicated loss is, of course, the primary concern. This is particularly important in the case of small business concerns, as these firms are frequently too thinly capitalized to remain solvent in the face of a significant loss. Even if the contractor is ultimately determined to be responsible, the resultant contract should receive intensive management due to the anticipated financial strain.

3. Bidder Responsibility.

In relation to the potentiality for subsequent default, the most important decision required of the contracting officer in the source selection process is the determination of responsibility. In this regard, DAR 1-903.1 states that a prospective contractor must satisfy the following minimum standards of responsibility:

- (1) Adequate financial resources, or the ability to obtain such resources as required during performance of the contract;
- (2) Ability to comply with the required delivery or performance schedule, taking into account all existing business commitments;

- (3) Satisfactory record of current and past performance, including tenacity and perseverance in completing contractual requirements;
- (4) Satisfactory record of integrity; and
- (5) Otherwise qualified and eligible under applicable laws and regulations.

While the contracting officer must ultimately exercise personal discretion in determining if an offeror meets the above criteria, he should avail himself of any current information which might influence his decision. Potential sources of such information as set forth in DAR 1-905.3 include: (1) the Joint Consolidated List of Debarred, Ineligible and Suspended Contractors; (2) information from the prospective contractor itself; (3) existing information within the Department of Defense; (4) publications; and (5) other sources. However, the primary source of supporting information for significant awards should be a pre-award survey performed by the cognizant DCAS office. The criteria set forth in DAR 1-905.4 state that a pre-award survey should not normally be requested for awards of \$25,000 or less, but there is an important exception to this general rule. This is in the case of a small business firm which may be referred to the Small Business Administration (SBA) for a Certificate of Competency (COC). In reality, any potential small business award in excess of \$10,000 must be considered a candidate for a COC in view of the criteria set forth in DAR 1-705.4(c). Finally, DAR 1-905.4(c)

cautions the contracting officer to request the contract administration office to verify information regarding current workload and financial capacity when considering any award which is significant in terms of either dollar value or requirement urgency. This emphasis parallels the methodology prescribed by this model. First, the \$25,000 threshold represents a standard measure of cost effectiveness. This is consistent with the iterative system of cost/benefit analyses espoused throughout this study. Second, the exception applied to potential COC candidates reflects particular concern over the responsibility of small business offerors. As will be seen in Chapter III, this concern is valid. Finally, the additional emphasis to be given capacity and credit in the case of "significant" awards reinforces the necessity of analyzing criticality indicators during the early stages of the acquisition cycle. Thus, by applying the applicable DAR guidance in conjunction with this model, requests for pre-award surveys can be prioritized on the basis of the cumulative effect of dollar amount, requirement urgency and business size. Additionally, particular emphasis can be given to workload and financial projections in specifying areas to be covered by the survey. This systematic approach will insure that resources are committed to significant actions only, and that the proper areas are emphasized during the review.

Having gathered all relevant information concerning the low offeror, the contracting officer must personally review this information prior to

reaching his responsibility determination. As this determination is clearly an independent judgment of the contracting officer, he must be satisfied that the prospective contractor can and will perform as required. Any questionable information in the pre-award survey should be clarified. If the contracting officer feels that the factual data in the survey does not support the conclusion set forth therein, a second opinion by internal experts may be advisable. Financial analysis is an area where internal validation of the pre-award survey results may be particularly beneficial. While the offeror's financial condition may not be so negative as to support a nonresponsibility determination, adverse indicators are often present. Raw financial data such as the current/acid test ratios, or the company's profit posture may be enlightening. The presence of ancillary information such as a bank letter of credit, an outside guarantee, or a subordination agreement indicates that the DCAS financial analyst was sufficiently concerned to request additional assurance of the firm's solvency. This is a crucial step in precluding subsequent performance failures and must be accorded the time and attention required.

Three options are available to the contracting officer in arriving at his award decision. First, the contractor may be considered to be fully responsible. Assuming that no other criteria for intensive management are present, contracts awarded on this basis should receive exception management. Second, various adverse indicators may be of such magnitude that the offeror

is determined to be nonresponsible. Except for potential awards to small business firms in excess of \$10,000 which require processing a COC request, such a determination dictates that no award be made to the contractor in question. Finally, while available information may not support a negative determination, it may, nevertheless, cause some degree of concern as to the offeror's ability to successfully perform the contract. In such cases, the prospective contractor should be considered to be marginally responsible, and intensive management should be applied.

4. Small Business Responsibility.

As touched on above, a determination of nonresponsibility involving a small business contractor is accorded special treatment. This is because the Small Business Administration (SBA) has the statutory authority to certify the competency of any small business concern as to all elements of responsibility. A contracting officer must accept the COC as being conclusive evidence of a prospective contractor's responsibility unless he has substantial doubt as to the firm's ability to perform. In that case, the matter can be referred to SBA Headquarters in Washington, DC, for final resolution. Certain exceptions to this general requirement are set forth under DAR 1-705.4. However, the procedure is normally required for awards in excess of \$10,000. The contracting officer should not allow the COC procedure to temper his discretion in arriving at his responsibility decision; there should be no hesitancy to determine a small business to be

nonresponsible simply because this decision may be overridden by the SBA. In fact, even marginally responsible offerors should be referred for a COC determination. This can provide two significant benefits. First, COC referral will provide either added assurance of the contractor's responsibility or confirmation that the contracting officer's doubts were well founded. Second, by alerting the SBA of the specific areas of concern, the contracting officer provides that agency an opportunity to give needed assistance to the marginally responsible firm. That is, if the firm's financial posture is weak, if management deficiencies are present, or if necessary equipment is not readily available, regular SBA assistance programs such as loans, management counseling, or assistance in locating equipment can be applied to strengthen the company. Further, SBA monitors progress on COC contracts on a monthly basis, constantly making needed assistance available to the contractor. Therefore, proper implementation of COC procedures can benefit all parties in both avoiding undue risks and maximizing chances for success.

CHECKLIST FOR PREDICTIVE INDICATORS
AT SOURCE SELECTION

- A. APPARENT "BUY-IN" BID
 - B. QUESTIONABLE RESPONSIBILITY
- Certificate of Competency Requested

- *Financial Resources Marginal
- *Capacity Marginal
- *Current/Past Performance Unsatisfactory
- *Perseverance/Integrity/Tenacity Questionable
- *Other Factors Marginal

5. Prescribed Actions.

Given the visibility gained during Contract Strategy Formulation and Source Selection, it is possible to display the characteristics of an action on a matrix. An example of a Contract Characteristics Matrix is included as Figure 4. Criticality indicators are displayed vertically, based on possible combinations of Criticality Designators and dollar levels. More finite categories could be established by further refining dollar levels or by taking differing payment provisions into account. The horizontal axis of the matrix reflects the number of adverse predictive indicators which have been identified. Due to the number of possible combinations of predictive indicators, only levels of magnitude have been included in the example. Individual commands may be able to refine these categories to reflect specific combinations of indicators which are prevalent in their particular operations.

Assignment of an action to the appropriate cell of the Contract Characteristics Matrix will provide a structural basis for management application.

Figure 4

Contract Characteristics Matrix

Predictive Criticality	0	1	2	3	4	5	Etc
Ah							
Al							
Bh							
Bl							
Ch							
Cl							

Legend: A, B, C = Criticality designators
 h, l = Dollar Value Categories
 h = \$100,000 or over
 l = Less than \$100,000
 0 = No adverse predictive indicators
 1 = Any one adverse predictive indicator
 2 = Any two adverse predictive indicators
 etc.

The determination of the actual level of management to be applied is largely a function of resource availability and judgment. Nevertheless, certain combinations of criticality and predictive indicators suggest intensive management. Conversely, certain combinations suggest exception management. Figure 5 is an example of a Management Application Matrix. It is constructed so that its cells correspond to the possible combinations reflected in the Contract Characteristics Matrix. By locating the corresponding cell in the Management Application Matrix, the contracting officer can determine if (1) intensive management should be applied; (2) exception management will be sufficient; or (3) further analysis is required. The example reflects a logical array of management application standards based on the judgment of the researchers. However, other standards are possible. For instance, personnel restraints may dictate expansion of the standard categories for exception management. Similarly, command experience may facilitate greater standardization, thus reducing the number of "F" cells in the matrix. While command flexibility is necessary, this type of management tool will serve as a vehicle for more systematic workload prioritization. The actual development and application of a management plan as a result of this analysis is discussed under Contract Management Application below.

D. Contract Management Application.

1. Planning Information.

Once the contracting officer has gathered and thoroughly analyzed the data discussed in preceding sections, he will have a considerable amount of information available with which to definitize a performance management

Figure 5

Management Application Matrix

Predictive Criticality	0	1	2	3	4	5	Etc
Ah	F	I	I	I	I	I	I
Al	F	F	I	I	I	I	I
Bh	F	F	F	F	F	I	I
Bl	E	F	F	F	F	F	F
Ch	E	E	E	E	F	F	F
Cl	E	E	E	E	E	F	F

Legend: I = Intensive Management

F = Further Analysis (A Function of Judgment
and Resource Availability)

E = Exception Management

plan. During Contract Strategy Formulation, the relative criticality of an ensuing default should have been established. In addition, predictive indicators should have been gathered by analyzing the nature of the item and the status of the marketplace. The latter should have been refined during Source Selection as the market was narrowed to a specific firm. Thus, the contracting officer should have finite information which is both item-specific and contractor-specific at the time of Contract Management Application. The tasks to be accomplished at this stage are to digest this information and to formalize a management plan accordingly.

Referring back to the Management Application Matrix, the relative absence of criticality or predictive default indicators should lead to the conclusion that only exception management is required. In this case, all that is necessary is to identify one or more significant performance milestones to be monitored. In the extreme, this may result in a determination to only verify that final delivery is made in a timely manner. However, it may also be advisable to monitor interim delivery dates, such as the submission of the first article test report. The philosophy should be to minimize the administrative burden while maintaining an acceptable level of performance visibility. Some form of suspense system should then be established to insure that these milestones are, in fact, monitored. A suggested suspense system methodology is elaborated in succeeding paragraphs. The point is that while every contract demands some degree of post-award surveillance, limited personnel resources must be prioritized. Not every contract can receive the luxury of intensive management application. In order to free the bulk of the available resources for more

problematic contracts, the decision must be made to reserve certain contracts for exception monitoring.

2. Formulation of a Desired Management Plan.

The first step in this process should be to formulate a desired management plan. That is, using information gathered in preceding phases, a tentative plan should be established which assumes full availability of resources. Once this surveillance plan is established, any portions of the plan requiring the support of other command elements should be identified. Such requirements should then be communicated to those elements immediately in order to facilitate their resource planning. The delegation of DCAS responsibilities is discussed below. However, advance planning in this regard should also be accomplished in order to ensure comprehensive, but not duplicative, management during performance.

3. Identification of Available Resources.

The next step should be to identify the total resources available for surveillance purposes and to determine the degree of their commitment to ongoing contracts. At the same time, the contracting officer should review the status of these ongoing contracts to determine if progress is sufficient to warrant converting them to exception management. Contractor performance may be entirely satisfactory, thus reducing the contracting officer's initial concerns. This illustrates the iterative process of information gathering and decision making which is recommended by this study. In due course, the instant action may also go through this conversion process. Conversely, contracts initially scheduled for exception management may ultimately receive intensive management due to the development of adverse performance indicators. The award of a new contract should alert the contracting officer to examine, and if appropriate, realign his

available resources.

It can be assumed that other functional managers will perform a similar analysis of resource availability and will advise the contracting officer of their ability to support the desired management plan. By assimilating information as to available resources (both internal and external), the contracting officer will now have the third parameter for definitizing a performance management plan.

Once the total available resources have been identified, the desired management plan should be reviewed to determine if full implementation is feasible. It may not be possible to provide the level of management which would be applied in an environment of unlimited resources. Therefore, it is important to prioritize surveillance requirements. Only the most significant performance milestones should initially be identified. These should reflect both Government and contractor responsibilities.¹⁶ If sufficient resources are available, an additional level of secondary milestones may be included. In short, the contracting officer should strive for optimum (but not necessarily maximum) visibility in the context of cost effective resource application.

4. Communication and Coordination.

As previously noted, initial communication and coordination with other functional elements within the command should already have been accomplished. However, once the management plan has been formally

¹⁶ If timely performance is dependent on a Government action (e.g., the prompt receipt of Government Furnished Materiel), the failure of the Government to take such action will provide an excuse for a subsequent delivery slippage.

established, special care must be taken to insure that all parties understand their responsibilities and obligations. Open communication is essential for quick reaction to adverse developments. While the contracting officer is properly the team leader, he cannot act in a vacuum. He must have timely information and all supporting elements must understand their roles in this regard. In the preceding section on Contract Strategy Formulation, it was noted that selected contracts might warrant convening a control board composed of interested functional elements. In that case, the impetus for such boards derived from item-specific factors. The criteria should now be broadened to include contractor-specific factors which arose during Source Selection.

A second avenue of communication which must be addressed is the delegation of responsibilities to the cognizant DCAS Office. Paragraph (c) under DAR 1-406, sets forth an extensive list of functions which are normally DCAS responsibility. These functions are performed as a matter of course under the authority of the above DAR citation, and a special delegation letter is not necessary if no special emphasis is required. However, DAR 1-406(a), provides that if special instructions pertaining to the administration of a particular contract are to apply, they should be set forth in a letter accompanying the contract when it is assigned to DCAS. This is a step which should not be slighted in the Contract Management Application phase. For DCAS to effectively administer a contract, it must be given visibility of any special concerns of the purchasing office. For example, if a given requirement is particularly

critical, an increased level of progress monitoring may be necessary. However, literally hundreds of contracts reflecting Criticality Designation "A" compete for limited DCAS resources. Therefore, in selected cases, a brief letter emphasizing the urgency of the requirement and requesting increased surveillance may be appropriate. Similarly, if progress payments are to be provided to a firm with a marginal financial posture, the need for exceptionally close financial surveillance can be conveyed in the delegation letter. These examples illustrate the manner in which both criticality designators (e.g., requirement urgency) and predictive indicators (e.g., weak financial condition) can serve as a basis for requesting increased DCAS support. As the name implies, DCAS is a service organization. However, in order for DCAS to respond to the needs of the purchasing office, open communication is essential. In this regard, it should be noted that DCAS resources may not always be adequate to perform all of the services requested. This is particularly true in the case of extraordinary surveillance requests. Therefore, it may be necessary to negotiate a mutually agreeable management plan based on resource availability. This is much like the contracting officer's internal resource prioritization discussed above.

In a closely related area, the use of post-award conferences is strongly encouraged. These conferences can serve a two-fold purpose. First, all Government personnel can meet to clarify their responsibilities. This will provide personal contacts which will improve communication during performance. Duplication of effort can be avoided, thus ensuring wise use of limited resources. Areas requiring additional emphasis can also be identified. Perhaps most importantly, the interest of the

purchasing office can be conveyed to DCAS, thus fostering a team approach to contract management. A second benefit provided by the post-award conference is the opportunity for purchasing office personnel to view the contractor's operation first hand. Again, personal contacts can be established, and valuable insights can be gained. Sacrificing such an opportunity on the basis of personnel or time constraints can prove to be false economy in the long run.

5. Definitization of the Contract Management Plan

Having thus communicated and coordinated with all Government elements, the contracting officer should definitize his contract management plan. All revisions necessitated by resource limitations should be incorporated. The final plan should then be documented and included in the contract file for future reference.

6. Implementation.

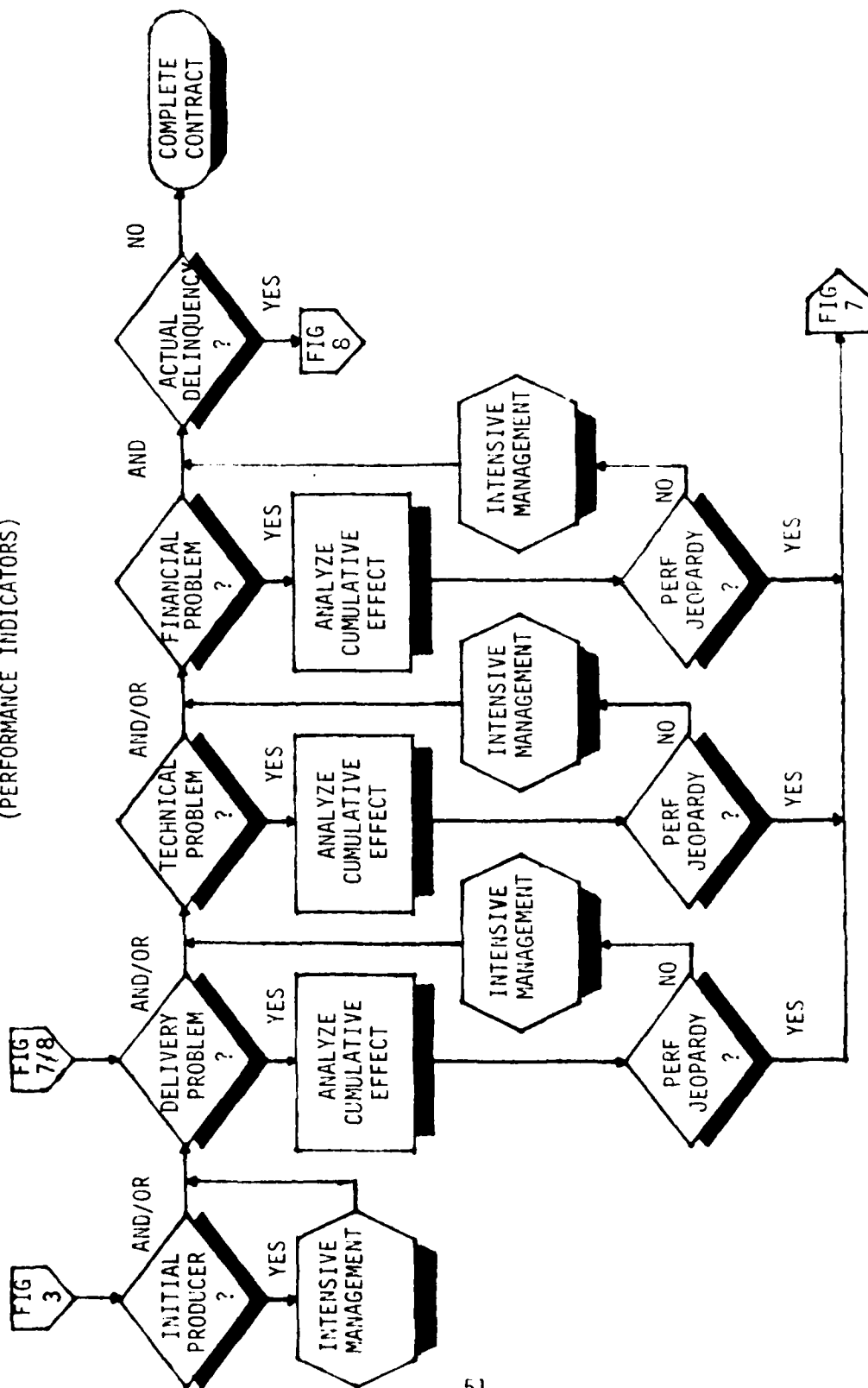
The planning activities outlined above are an essential element of performance management. However, good planning is of no value in the absence of effective implementation of the plan. Therefore, the following paragraphs concentrate on the application of the performance management plan thus developed. This phase of the process is reflected in Figure 6.

7. Passive and Active Performance Indicators.

The primary concern of the management application phase is the identification and treatment of performance indicators. These indicators can be categorized as being either passive or active. A passive indicator can be defined as the absence of evidence that a performance milestone has been completed. For example, the absence of a Material Inspection and

FIGURE 6

CONTRACT MANAGEMENT APPLICATION
(PERFORMANCE INDICATORS)



Receiving Report (DD Form 250) indicating first article acceptance would be a passive indicator of performance difficulties. Conversely, the prompt receipt of the DD Form 250 would be an active indicator that performance to date is satisfactory. The receipt of a Delay in Delivery (Flash Notice) (DD Form 375-2) would be an active indicator of performance difficulties. This passive/active dichotomy is reflected in the succeeding paragraphs of this chapter. The suspense system discussed immediately below advocates a methodology aimed primarily at increasing sensitivity to passive indicators. Subsequent paragraphs set forth examples of active indicators which should be monitored by the contracting officer.

8. Establishment of a Milestone Suspense System for Passive Indicators.

An integral part of Contract Management Application should be identifying and monitoring key performance milestones. In order to monitor the achievement of these milestones, some form of suspense system is required. Given the number of contracts for which the contracting officer is generally responsible, he cannot be expected to have instant recall of each milestone under each contract. Nor can he be expected to recognize the absence of milestone achievement (an adverse passive indicator) without an active reminder to verify performance status. Whether the system is manual or automated, some external memory aide is needed. As noted above, in the case of exception management the events to be monitored may be quite simplistic. However, in the case of a complex contract with an elaborate network of interrelated pacing events, a more sophisticated suspense system becomes increasingly important. It is again emphasized that both Government and contractor performance milestones should be included. Ideally,

the command's ADPE capabilities should be utilized for this purpose, in order to minimize the expenditure of manual resources. However, whatever the approach employed, an efficient suspense system is an absolute necessity if passive indicators of performance failures are to be recognized in a timely manner.

9. Management of Active Indicators.

With the management plan formalized and the suspense system operational, all that is left is to monitor contractor progress for the appearance of active indicators of adverse developments. The suspense system is the primary mechanism to insure compliance with pre-established performance milestones. However, these milestones may be interspersed with significant time lapses. Therefore, the contracting officer must always be alert for the advent of adverse performance indicators during these periods. In a sense these are also predictive indicators. However, they are less speculative, reflecting actual problems in performance. Performance problems may surface in many areas. Similarly, information available to the contracting officer may take many forms. Therefore, the contracting officer must be sensitive to a wide variety of active indicators if he is to make informed judgments with regard to Default Disposition. Several of the more common active performance indicators are discussed below. However, the examples presented are neither collectively exhaustive nor mutually

exclusive. In fact, it may well be the combined effect of several independently minor indicators which provides visibility of an unavoidable performance failure.

10. Active Indicators of Lack of Physical Progress.

The first group of performance indicators directly reflects the contractor's physical progress. These indicators surface as a result of progress reports furnished by the contractor and/or the various Government offices which support the contracting officer. As previously noted, contractor progress reporting must be supported by a contractual provision. DCAS reporting is requested at the time the contract is delegated for administration. In addition, if a contracting officer's technical representative (COTR) is assigned, he should be asked to provide periodic status reports. While these reports are straightforward representations of contractor performance, they may not provide all of the information required to support a termination decision. Nevertheless, they should provide the impetus for additional information gathering and informed decision making. It should also be noted that such reports may indicate that progress is satisfactory, thus allowing the revision of the plan to provide only exception management in subsequent stages. This, in turn, provides for reallocation of resources to more problematic contracts.

11. Active Indicators of Technical Difficulties.

The second group of performance indicators reflect technical difficulties being encountered by the contractor. Contractor requests for waivers and/or deviations are evidence of such difficulties. Another source of visibility in this regard are COTR reports. These may result from the COTR's regular surveillance or from informal intelligence provided by his technical counterpart in the contractor's organization. Similarly, they may be provided to the contracting officer on a formal or informal basis. It can be seen that good communication between the contracting officer and the COTR is essential in monitoring technical difficulties. In a similar vein, open communication with the DCAS office must be maintained. By virtue of geographic proximity, the various DCAS elements often have a great deal of insight as to many areas of the contractor's operations. With regard to technical problems, the Industrial Specialist and/or the Quality Assurance Representative assigned to the contract are excellent sources of information. Early contact with these individuals is essential for intensively managed contracts. However, it must be recognized that the mere occurrence of technical difficulties does not establish the cause of these difficulties. It was emphasized in the section entitled Contract Strategy Formulation that specification inadequacies may lead to excuses for performance failures. If the analysis prescribed by this study is conscientiously performed at the outset, the incidence of Government

culpability during performance should be minimized. Nevertheless, the adequacy of the technical data package should be reverified in light of the specific problem at hand. If Government fault is indicated, an equitable adjustment or a convenience termination may be in order. If the fault lies clearly with the contractor's technical shortcomings, contractual remedies up to and including termination for default may be appropriate. Each situation calls for a judgmental decision. However, before discretion can be exercised as to remedies to be pursued, the causative factor(s) must be established.

12. Active Indicators of Financial Problems.

The final major grouping of performance indicators falls under the heading of financial problems. Such problems may be manifest in contractor requests for upward price adjustments. More frequently they may be evidenced by contractor requests for revised payment provisions, such as inclusion of progress or advance payments subsequent to award. However, the primary source of financial visibility should be the DCAS Administrative Contracting Officer (ACO) assigned to the contract. DAR 1 406(c)(xiv) provides that the ACO is normally charged with monitoring the contractor's financial condition and advising the procuring contracting officer (PCO) when performance is jeopardized by adverse developments. It is important to note that the DAR specifically tasks the ACO with surveillance responsibility for the contractor as a whole, thereby not limiting his duties to

a specific contract. In the event of financial difficulties or bankruptcy, the ACO must immediately notify affected PCO's by the most expeditious means. No specific format for such notification is prescribed. However, if advance or progress payments are provided for in the instant contract, the ACO should issue a Report of Adverse Development¹⁷ in the event of material financial difficulties. Such reports are to be issued as soon as there are indications that the contractor's financial condition is unstable, not delayed until it is a foregone conclusion that the contractor will be unable to continue performance for financial reasons. Therefore, they should provide visibility of potential performance failure in advance of actual bankruptcy. Other sources of information which reflect financial difficulties specific to the instant contract include bank assignments and loss ratio applications to progress payment requests. Revised financial statements may also be made available, either through the ACO or directly from the contractor. In the final analysis, due to his responsibilities for financial surveillance and payment approval, the ACO must be relied upon as the primary focal point for financial visibility during performance.

Once again, the above list of performance indicators is not all inclusive. The contracting officer must be alert for any other information which presents itself. However, the list is considered to be representative of adverse indicators which may be available.

¹⁷
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Each time that any adverse performance indicator is surfaced to the contracting officer, he must determine its potential impact on successful performance. Any additional information required to determine the severity of the problem should be obtained. Further, the development in question should be analyzed in conjunction with all other performance indicators. As previously noted, it is often the combination of individual indicators which is most significant. The Checklist for Adverse Performance Indicators during Contract Management Application can be an effective tool in this regard.

CHECKLIST FOR ADVERSE PERFORMANCE INDICATORS DURING
CONTRACT MANAGEMENT APPLICATION

- I. PASSIVE PERFORMANCE INDICATORS
 - A. Interim Milestone Slippage _____
 - B. Terminal Milestone Slippage _____
- II. ACTIVE Performance Indicators
 - A. Lack of Physical Progress
 - * Adverse Contractor Progress Reports _____
 - * Adverse DCAS Progress Reports _____
 - * Adverse COTR Reports _____
 - * Requests for Delivery Extensions _____

a specific contract. In the event of financial difficulties or bankruptcy, the ACO must immediately notify affected PCO's by the most expeditious means. No specific format for such notification is prescribed. However, if advance or progress payments are provided for in the instant contract, the ACO should issue a Report of Adverse Development¹⁷ in the event of material financial difficulties. Such reports are to be issued as soon as there are indications that the contractor's financial condition is unstable, not delayed until it is a foregone conclusion that the contractor will be unable to continue performance for financial reasons. Therefore, they should provide visibility of potential performance failure in advance of actual bankruptcy. Other sources of information which reflect financial difficulties specific to the instant contract include bank assignments and loss ratio applications to progress payment requests. Revised financial statements may also be made available, either through the ACO or directly from the contractor. In the final analysis, due to his responsibilities for financial surveillance and payment approval, the ACO must be relied upon as the primary focal point for financial visibility during performance.

Once again, the above list of performance indicators is not all inclusive. The contracting officer must be alert for any other information which presents itself. However, the list is considered to be representative of adverse indicators which may be available.

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B. Technical Difficulties

*Requests for Waivers/Deviations _____

*Adverse DCAS Reports _____

*Adverse COTR Reports _____

C. Financial Problems

*Requests for Upward Price Adjustments _____

*Requests for Revised Payment Provisions _____

*ACO Reports of Adverse Developments _____

*Bank Assignments _____

*Loss Ratio Application to Progress
Payment Requests _____

*Revised Financial Statements _____

Once all necessary information has been gathered, the contracting officer must determine if performance appears to be in jeopardy. If so, he should immediately contact the office of counsel in order to determine if legal grounds exist to pursue a default termination in light of the factual data. A detailed discussion of the deliberations which precede the contracting officer's decision, together with the various options available for disposition, is included in succeeding sections of this study.

E. DEFAULT DISPOSITION.

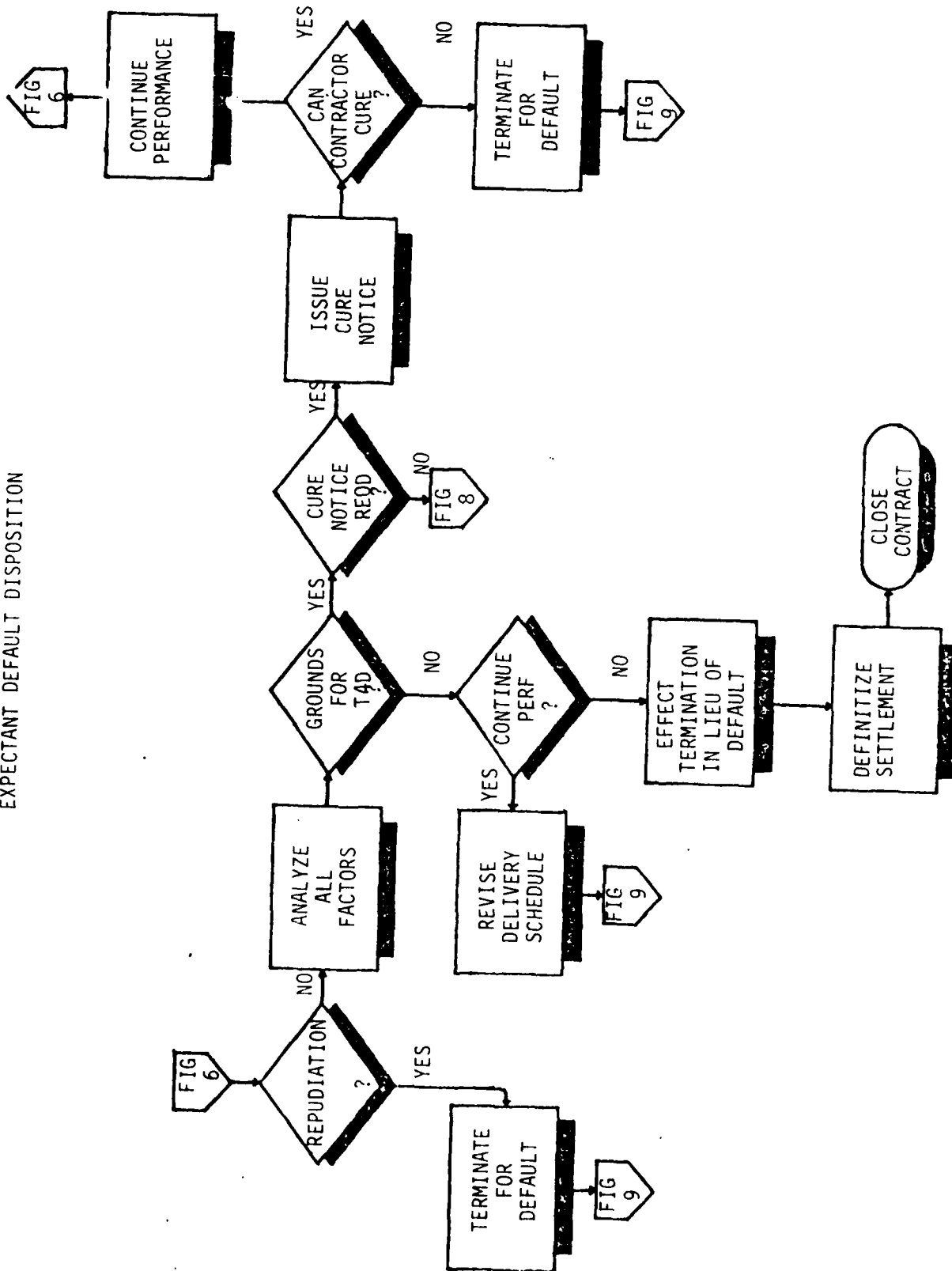
In view of the fact that different procedures apply to the disposition of expectant and actual defaults, each type will be treated separately below. A separate section on partial termination for default is also included. The procedures are presented in the format of decision trees which represent the mental processes inherent in determining whether or not termination of a contract for default is in the best interest of the Government. Some of the basic legal and regulatory requirements are discussed. However, this is a dynamic area of contract law, and the contracting officer is cautioned to seek the advice of legal counsel as soon as default termination appears to be a possibility.

1. Expectant Default.

In order to arrive at this decision point, the contracting officer must have determined that one or more adverse indicators reflect that performance is in jeopardy. Having made this determination, the following methodology should be applied to decide upon a course of action to be pursued. Figure 7 depicts the decision tree which should be followed in this regard.

The contracting officer should first determine if an anticipatory repudiation of the contract has occurred. The elements constituting anticipatory repudiation are as follows:

FIGURE 7
EXPECTANT DEFAULT DISPOSITION



- (a) A positive intention not to perform on the part of the contractor;
- (b) The communication of that intent to the Government;
- and
- (c) The reliance by the Government on the contractor's communication of intent.

An anticipatory repudiation can be established by a direct statement from the contractor that he does not intend to perform the contract. It can also result from the contractor's conduct. For example, a voluntary petition for bankruptcy or abandonment of the work by the contractor could also constitute repudiation. In either case, the statement or conduct must show unequivocal intent not to perform the contract. Statements to the effect that the contractor "might not" perform are not sufficient in this regard.¹⁸ Reliance on the contractor's communication of intent can be clearly demonstrated by the timely issuance of a default termination notice. As amplified below, the Government is normally required to issue a cure notice prior to terminating a contract on the

¹⁸

Dr. James O. Mahoy, ed., Government Contract Law, 4th ed. (Ohio: Air Force Institute of Technology, 1975), p. 166.

basis of expectant default. However, in the case of anticipatory repudiation, no cure notice is required. The notice of termination can be issued immediately, without allowing the usual period for corrective action.

If no anticipatory repudiation has occurred, the contracting officer must next determine if other grounds exist for expectant default termination. Two major criteria must be satisfied.

First, the contracting officer must consider the possibility of an excusable delay. As previously noted, Government actions or inactions may serve to establish an excuse for performance failure. Additional examples of excusable delays are set forth under paragraph (c) of the "Default" clause. Essentially, in order to establish an excusable delay, it must be demonstrated that any performance failure arose out of causes beyond the control and without the fault or negligence of the contractor. Special criteria are included for delays caused by subcontractors. Such delays must be beyond the control and without the fault or negligence of either the prime or subcontractor. In this regard, it is essential that the prime contractor has exhausted the possibility of obtaining the sub-contracted items from other sources in a timely manner. If it is determined that an excusable delay exists, the contracting officer must determine whether or not to continue performance. If so, a revised delivery schedule should be established, and the contract should be modified accordingly. If not, a termination in lieu of default (most often a termination for

convenience) should be effected. In the event that no excusable delay is apparent, the contract will not automatically be terminated for default. However, the first hurdle has been cleared.

The second major consideration in this regard is to determine if the contractor's failure to make progress, in fact, seriously endangers performance. On the surface this seems redundant to the previous determination that performance was in jeopardy. However, in making the present decision the contracting officer must apply much more exacting criteria. This is due to the fact that the Government has a heavy burden of proof in pursuing and sustaining an expectant default termination. This is an evolving area of case law, and the need for assistance from legal counsel is once again emphasized. However, certain basic guidelines can be offered. It was traditionally held that a failure to make progress could not be demonstrated unless it was impossible for the contractor to complete performance of the contract within the time remaining on the schedule. This placed the contracting officer in a very difficult position. In essence, he could not confidently terminate for default until such time as the contractor could no longer complete the effort, even if efficiency and tempo were increased. Consequently, it was virtually impossible to terminate a contract early enough to replace a delinquent contractor and obtain performance in a timely manner.¹⁹ However, a recent decision of the Armed Services Board

¹⁹ Government Contracts Program, pp 168-169.

of Contract Appeals (ASBCA) appears to have relaxed the burden of proof requirements to some degree. In a 1977 decision, the Board found that the Government was not required to prove that it was impossible for the contractor to complete performance on schedule. Rather, the Government was only required to prove the following:

(a) That there was a lack of progress; and

(b) That contract completion was, therefore, endangered since there was no "reasonable likelihood" of recovery.

This would appear to be a major relaxation of the previous burden of proof standards. However, the Board emphasized the fact that the contractor had failed to satisfactorily reply to the contracting officer's requests for information to assure that timely performance was still possible. Such failure was, in effect, viewed as anticipatory repudiation of the contractor's obligations.²⁰ Therefore, it is by no means clear whether this decision represents a relaxation of the burden of proof criteria or simply a definition of actions (or inactions) constituting anticipatory repudiation. In either event, some liberalization in the area of expectant default is indicated. This, in turn, provides some encouragement for pursuit of terminations on that basis in the future. However, two additional points must be made. First, even if a more liberal doctrine is adopted, solid factual data upon which to forecast an ultimate performance

²⁰ Marshall J. Doke, Jr., ed., Developments in Government Contract Law: 1977 (Chicago: American Bar Association, 1978), pp 194-198.

failure is required. Compilation of this data is clearly the responsibility of the contracting officer. Counsel can advise if the legal doctrines support a default termination based on the information at hand, but no lawyer can offer an opinion without a solid factual basis. Second, in order to build a case, the contracting officer must have visibility of performance progress. In order to obtain this visibility, the steps outlined in preceding sections should be followed.

Once the above criteria are met, the contracting officer has essentially established that grounds for an expectant default termination exist. However, this does not mean that this course of action is in the best interest of the Government. In short, the action is still discretionary.

DAR 8-602.3 provides that when a default termination is being considered, a decision as to the type of termination action to be taken (i.e., for default, for convenience, or a no cost cancellation) shall be made only after review by procurement and technical personnel, and by counsel, to assure the propriety of the proposed action. Factors to be considered include:

- (a) The provisions of the contract, and the applicable laws and regulations;
- (b) The specific failure of the contractor, and, time permitting, any excuses for such failure (see above);
- (c) The availability of alternate sources for reprocurement;

(d) The urgency of the requirement, and the leadtime associated with reprocurement as compared with the time in which delivery could be made by the original contractor;

(e) The essentiality of the contractor in the Government procurement program, and the effect of a default termination on its capability as a supplier under other contracts;

(f) The effect of the default termination on the ability of the contractor to liquidate guaranteed loans, progress payments, or advance payments; and

(g) Any other pertinent facts and circumstances.

With regard to item (f), above, the Army DAR Supplement provides that, except in cases of bankruptcy, contracts involving outstanding guaranteed loans, progress payments, or advance payments shall not be terminated for default without prior coordination with the Head of the Procuring Activity or his representative.²¹

Having considered the factors discussed above, the contracting officer may determine not to pursue a termination for default. If not, several alternatives are set forth in DAR 8-602.4.

First, he can permit the contractor, his surety or his guarantor to continue performance under a revised delivery schedule. In the absence of an excusable delay, any schedule extension should be supported by

²¹ Army DAR Supplement 8-602.3(a).

consideration to the Government. Such consideration may be in many forms. A suggested form under these circumstances is the incorporation of additional contractor reporting requirements into the contract. In view of the fact that there is no assurance that the contractor will be able to perform in accordance with the revised schedule, intensive management should be applied during the ensuing performance period. Consideration in the form of additional progress reporting will facilitate this increased management application.

Next, the contracting officer may permit the contractor to continue performance by means of a subcontract, or other business arrangement, with an acceptable third party. Any such agreement must adequately protect the rights of the Government. Whatever measures that are necessary should be employed to insure the responsibility of the third party. Again, intensive management is indicated.

Finally, if the requirement no longer exists, and if the contractor is not otherwise liable to the Government for damages, the contracting officer may execute a no cost termination settlement agreement.

Having considered the foregoing options, if the contracting officer determines that a termination for expectant default is in the best interest of the Government, he should immediately issue a "cure notice" to the contractor.²² The cure notice must be in writing, must specify the failure constituting default, and must provide a period of ten days (or longer if

²² If less than ten days remain before delivery is due, it is normally advisable to forego a cure notice, wait until a delivery failure occurs, and proceed with termination on the basis of actual default.

authorized) to cure the failure. A cure notice is intended to provide the contractor with an opportunity to cure the cited problem prior to the implementation of default terminations procedures.²³ If the contractor's reply satisfies the contracting officer that the problem has been corrected, performance must be allowed to continue. Intensive management should, of course, be applied. If the problem has not been corrected, or if no reply is forthcoming, the contracting officer should immediately terminate for default.

As provided by DAR 8-602.3(d), the notice of termination shall:

- (a) Set forth the contract number and date;
- (b) Describe the acts or omissions constituting the default;
- (c) State that the contractor's right to proceed further with performance of the contract (or a specified portion thereof) is cancelled;
- (d) State that the supplies or services terminated may be reprocured against the contractor's account, with the contractor being held liable for any excess costs;
- (e) State that the Government reserves all rights and remedies provided by law or under the contract in addition to charging excess costs; and
- (f) State that the notice constitutes a decision that the contractor is in default as specified, and that the contractor has the right to appeal as specified in the "Disputes" clause of the contract.

²³ DAR 8-602.3(b)(4) provides that a copy of any cure notice issued to a small business contractor is to be provided to the nearest SBA Regional Office.

The DAR goes on to advise that the notice of termination should also be used to rebut an allegation of an excusable delay, if appropriate. This is particularly important in that the notice of termination will be a primary piece of evidence in the event of an appeal to the ASBCA or the courts. The inclusion of rebuttals thus helps to establish the record upon which the appeal will be judged.

A few comments on termination notice draftsmanship are in order. The introductory paragraphs should include a brief recitation of findings of fact. As in the case of rebutting excusable delays, this can serve as a means of building a factual record which is favorable to the Government's case.²⁴ This is not to imply that such findings should not be objective and impartial. It is simply an opportunity to present the data which resulted in the contracting officer's determination to terminate for default. This should be followed by a formal determination that the factual data thus cited constitutes default under the purview of the clause. This determination should be stated in broad terms, if possible, in order to provide counsel the maximum latitude in the event of appeal. Finally, if the contract includes unliquidated progress payments, a statement of demand for the amount of such payments should be included.²⁵ In the event of contractor bankruptcy, a claim in the amount of the unliquidated progress payments should be filed with the appropriate court and cited in the notice of termination.

²⁴

It must be emphasized that this information will only serve as a part of the factual record upon which any appeal will be judged; it is not binding on the board.

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See paragraphs (h) under DAR 7-104.35(a) and (b).

As a final step in the termination process, the file should be properly documented in accordance with DAR 8-602.5.

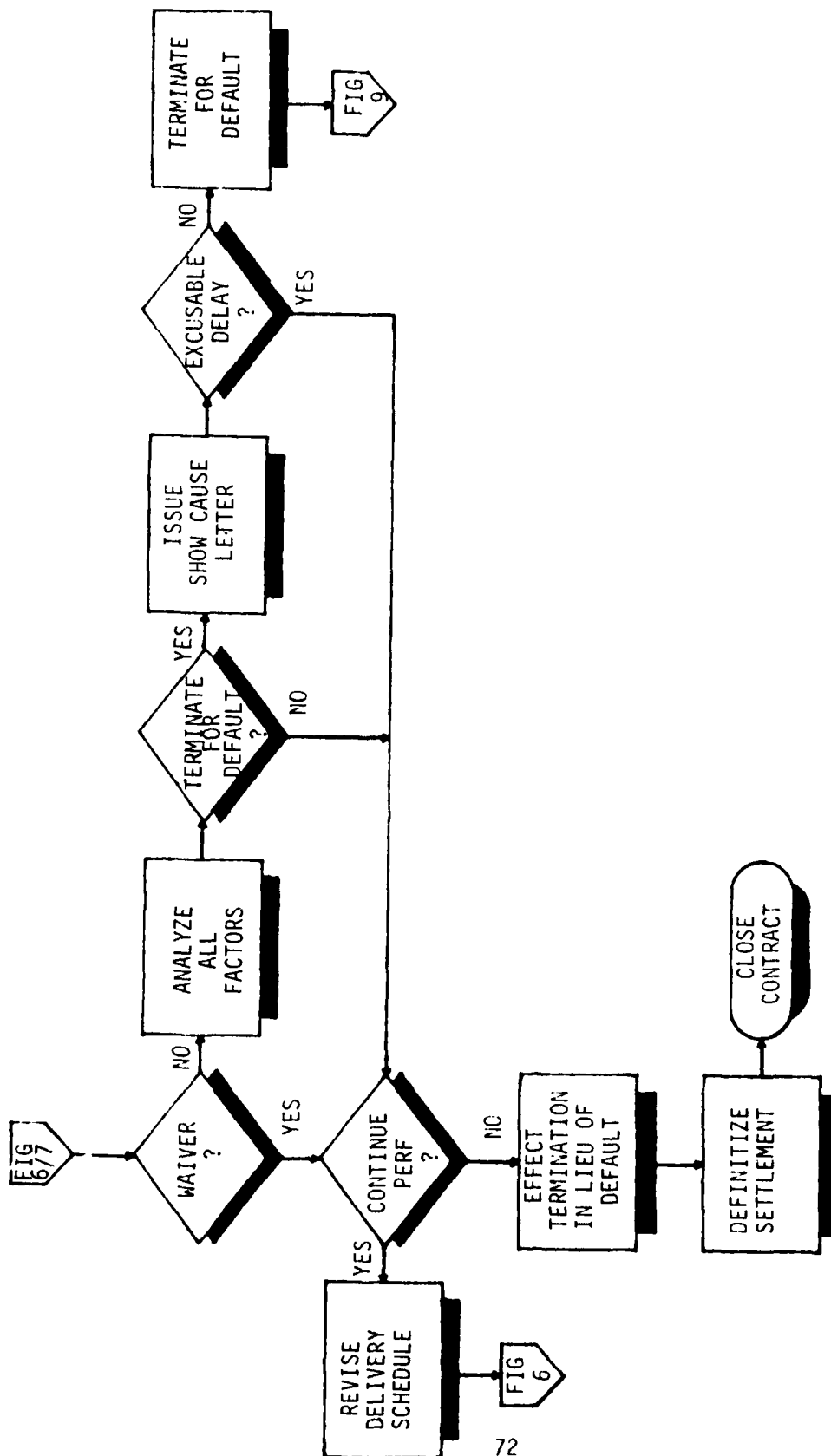
2. Actual Default.

This type of contractor default occurs when the required delivery date has actually passed without satisfactory performance. Many of the considerations required of the contracting officer in determining whether or not to pursue a termination for expectant default are also applicable here. Such common areas will simply be cross referenced below. The emphasis of this section will be on the differences in the treatment of Actual Default. Figure 8 depicts the decision tree applicable to this type of Default Disposition.

Anticipatory breach is not normally an issue in the case of an actual default in view of the fact that an actual performance failure has occurred. However, in an analogous situation, the contractor may have repudiated his obligation to perform. This may be evidenced by an expression of intent to discontinue performance, such as a letter stating the contractor's intent. It may also occur by virtue of the contractor's action, such as abandoning its facilities and filing for bankruptcy. Either action constitutes grounds for a default termination. Procedurally, the only peculiarity of this circumstance is to negate the use of a "show cause" letter (see discussion below).

FIGURE 8

ACTUAL DEFAULT DISPOSITION



If the contractor has not repudiated its obligations under the contract, the contracting officer should first determine if there has been a waiver of the right to terminate for default on the part of the Government. In essence, the Government is allowed a reasonable period of time after a contractor has become delinquent in which to act upon a possible termination for default. This is called the period of forbearance. However, if the Government takes an unreasonable period to make its decision, it may have waived the delivery schedule. This, in turn, waives the right to terminate for failure to deliver in accordance with that schedule. There is no fixed standard of reasonableness in this regard. The amount of time which is reasonably required to reach a determination is dictated by the circumstances at hand. However, there are two basic elements required for waiver of a delivery schedule.

(a) Reliance by the contractor on conduct by the Government which encourages continued performance after the delivery date has passed; and

(b) Incurrence of performance costs as a result of such reliance.

If schedule waiver has occurred, the contracting officer must determine whether or not to continue performance. If not, a termination in lieu of default (as discussed above) is appropriate. If performance is to be continued, two possibilities exist. Ideally, a revised delivery schedule should be mutually agreed upon and incorporated into the contract by bilateral agreement. If this is not possible, the Government can unilaterally

establish a new schedule. The contractor must be clearly notified of the new schedule; a unilateral modification of the contract is the preferred method of notification. Further, the revised schedule must be both specific and reasonable in view of the performance capabilities of the contractor at the time the notice is given.²⁶ Again, no rule of thumb exists for establishing reasonableness. If the schedule is revised by either of the above means, intensive management during the extended period is appropriate.

Assuming that an actual delivery slippage has occurred and that the schedule has not been waived, the only remaining obstacle in determining if grounds for default termination exist is eliminating the possibility of an excusable delay. The basic guidance in this regard is set forth under expectant default above. However, in the case of actual default, the primary vehicle for surfacing a contention of an excusable delay is the "show cause" letter.²⁷ This is essentially a notice to the contractor that the Government is contemplating a termination for default. It provides the contractor with an opportunity to show cause why such a termination should not be implemented. Generally, a ten day period is provided for response, although a longer period may be granted at the contracting officer's discretion. Normally, any cause cited by the contractor will take the form of an excusable delay contention. If an excuse is alleged, it must be considered on its merits. It should also be noted that the

²⁶
Government Contracts Program, pp 173-174.

²⁷
Unlike the cure notice discussed above, the use of a show cause letter is not required; however, its use is strongly encouraged.

show cause letter can serve a secondary purpose in avoiding the appearance of waiver. It is difficult for a contractor to allege that it was being encouraged to continue performance at the same time it was being requested to show cause why the contract should not be terminated for default.

If the contractor's reply to the show cause letter does not establish an excusable delay, the contracting officer can be reasonably assured that grounds for a default termination exist. He should then refer to the guidance set forth in DAR 8-602.3 in order to determine if a termination for default is in the best interest of the Government. With the exception of the cure notice requirement in the case of expectant default, the factors, options and procedures set forth in the preceding section are also applicable to actual default.

As a final note on termination for actual default, the contracting officer may wish to use a telegraphic notice of termination. While the content of such a notice should reflect the DAR requirements outlined above, it can be much less elaborate. The primary advantage to this procedure is the avoidance of waiver. In every case, it should be followed by a formal letter signed by the contracting officer which elaborates the contents of the telegraphic notice.

3. Partial Termination for Default.

This procedure is derived from the right set forth in the "Default" clause to terminate "the whole or any part" of the contract. Its use within

DARCOM is infrequent, and no recently completed actions were available for review. However, personnel interviews indicated that it was a fairly common practice with ammunition producers during the Southeast Asian era. During that period, requirements for ammunition were extremely urgent. Further, an active base of multiple suppliers was maintained. If one of these active contractors was unable to deliver a given monthly increment, that increment would be terminated for default. The required quantity would then be reprocured from one (or more) of the other active producers which had excess capacity. The terminated increment was normally delivered by the reprocurement contractor(s) in the following month, thus minimizing impact on the load, assembly and pack lines at Government Owned Contractor Operated ammunition plants. While the Government retained its rights to assess excess reprocurement costs, this was normally unnecessary. First, the industry was so competitive that minimal price differentials existed. In fact, increased economies of scale might result in a lower cost to the Government. Second, ammunition contractors are frequently dependent on Government furnished industrial plant equipment. The contractor's default was often a result of problems caused by malfunctions of this equipment. If so, the delay was excusable. In sum, while technically a termination for default, in practice this procedure more closely resembles a partial no cost cancellation based on mutual culpability. Specific factors to be considered when a partial default termination is contemplated are set forth under DARCOM PI 8-602.3.

F. REPROCUREMENT ACTION.

After a contract is terminated, the "default" clause provides the Government the right to purchase the affected items from another source. Any excess costs associated with such reprocurement are charged to the defaulting contractor. In addition, paragraph (f) of the clause reserves to the Government all other rights and remedies provided by law or under the contract. These aspects of Reprocurement Action are treated in order in ensuing paragraphs. Figure 9 graphically depicts this process.

1. Similar Item.

In order to repurchase against the defaulting contractor's account, the requirement for the item must still exist. If not, no reprocurement is pursued, and no excess costs are assessed. If so, the item repurchased must be the same or similar to the item which the defaulting contractor was required to deliver. The word "similar" as used in the "Default" clause means similar in physical and mechanical characteristics, as well as functional purpose. For example, the ASBCA has held the substitution of a vacuum tube calibrator for a transistor (solid state) calibrator to be substantially different.²⁸ In another case, the ASBCA reduced the reprocurement costs of a chair where the specifications were changed to add the additional features of an adjustable back, deep cushioning and an arm brace on each side.²⁹ Thus it can be seen that specifications must be materially

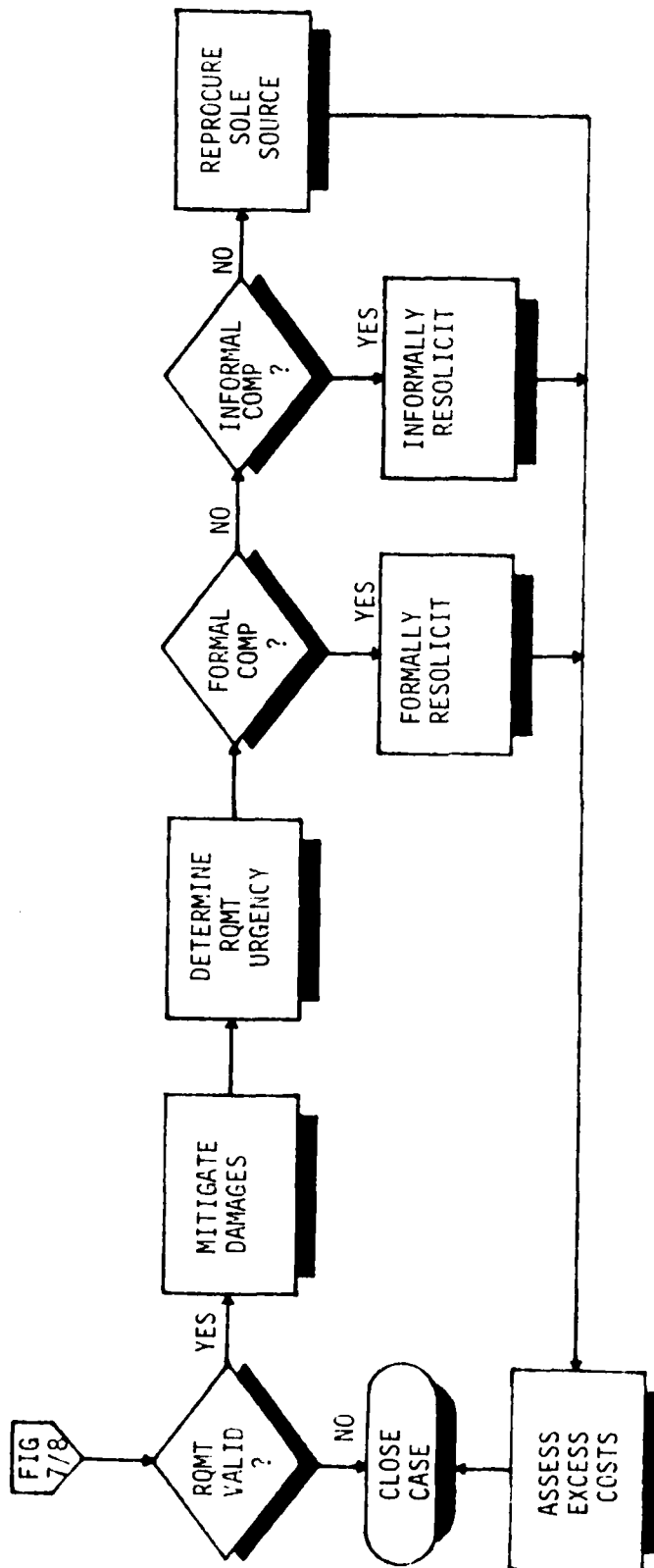
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Lome Electronics, Inc., ASBCA Nos. 8642 and 8707, 1963 BCA § 3933 (1963)

29

Carb Manufacturing Co., ASBCA No. 1164, 2 Government Contract Reports, §12,575 (at page 6430) (1953).

FIGURE 9
REPROCUREMENT ACTION



similar. All other terms and conditions should also be as similar as possible to the defaulted contract. In addition, the Government must reprocure the terminated items within a reasonable time in order to hold the defaulting contractor liable for excess costs. What is a "reasonable" amount of time is dependent on all aspects of the situation at hand. Finally, the reprocurement must be made at a reasonable price. Methods for insuring price reasonableness are discussed in succeeding paragraphs.

2. Mitigation of Damages.

The Government has the duty to mitigate (i.e., minimize) the damages to the defaulting contractor, in light of all facts and circumstances surrounding the reprocurement. Such mitigation must be accomplished in every way possible. For example, acceptance of partial delivery may be possible. Similarly, the Government can take title to the defaulting contractor's work in progress inventory and credit its fair value against any excess costs. Sale of the contractor's inventory is also possible. In another area, the Government should take advantage of available freight savings on the reprocurement contract. Again, the means of mitigation are largely dictated by the instant situation. The governing principle is to minimize the reprocurement cost in any way possible.

A key aspect of mitigating damages is insuring that the price paid on the reprocurement contract is reasonable. If not, the Government may lose

its right to assess excess costs in whole or in part. In essence, all actions discussed in the preceding paragraphs are aimed at insuring price reasonableness. However, of special concern is the method employed to effect the Reprocurement Action. Guidance in this regard is set forth under DAR 8-602.6. Basically, the DAR provides that repurchase shall be at as reasonable a price as practicable in light of quality and time constraints. It is the time within which the reprocurement items must be obtained which have the greatest impact on repurchase methodology. The DAR states that, except in cases where the reprocurement quantity is in excess of the terminated quantity, use of formal advertising is optional. However, particularly in cases where the original procurement was formally advertised, this is the preferred method of placement. Time is the pacing factor for the use of formal advertising, as the steps required cannot normally be compressed. Even if formal advertising is employed, the award of a reprocurement contract to the low bidder does not insure price reasonableness. However, it is the safest course of action to pursue. In the event that circumstances do not permit formally advertised placement, the contracting officer is authorized to negotiate under the authority of any DAR exception which is appropriate.³⁰ If none of these exceptions is used, the reprocurement contract is to be identified as a repurchase in accordance with the "Default" clauses of the defaulted contract. This will serve as the authority to

³⁰

DAR 3-201 through 3-217.

negotiate. If the reprocurement is negotiated, competition should be employed to the degree possible. This may take the form of telephonic quotes, similar to small purchase procedures (i.e., informal competition). In the event that urgency precludes competition of any sort, the contract must be placed on a sole source basis. The second low bidder on the defaulted contract may be willing to undertake the work at the price originally quoted. A prior producer is another possible source for reprocurement. The principle which must be remembered is that the contracting officer has the duty to select the method which will mitigate the defaulted contractor's damages within the time constraints imposed.

3. Assessment of Excess Costs.

Having accomplished the reprocurement in accordance with the above guidance, DAR 8-602.7(c) requires the contracting officer to make a written demand on the defaulted contractor for any excess costs. It is important to note that, while the DAR indicates that this action is to be taken as soon as the reprocurement contract is awarded, the ASBCA has generally held that excess costs cannot be collected until the repurchase contract has been performed and payment has been made³¹ The debt thus established is transferred to the Director of Contract Financing, Office of the Comptroller of the Army, for collection.³²

³¹ See, e.g., American Supply Co., ASBCA No. 13558, 69-1 BCA, § 7700 (1969).

³² DAR E-611.

4. Other Rights and Remedies.

As previously noted, in addition to excess reprocurement costs, the "Default" clause reserves to the Government all other rights and remedies provided by law or under the contract. This is a rather rare occurrence and will be treated briefly here. An example of an additional remedy under the contract would be the collection of liquidated damages under the purview of DAR 7-105.5. With regard to rights provided by law, the Government might be due payment for costs attributable to schedule lapses at a production line which was dependent on defaulted components. In assessing such damages, the Government must show that the damages were foreseeable and in the contemplation of the parties at the times of award. Again, counsel involvement will in all likelihood be required prior to initiating such remedies.

CHAPTER III

Contract Termination Experience

A. Overview.

Succeeding sections of this chapter are presented in parallel with the time phased decision points identified in the Prescriptive Model for Performance Management. However, before proceeding with this analysis some comments regarding the overall system are in order.

First, this research uncovered no major problems with either Default Disposition or Reprocurement Action per se. However, the steps taken by DARCOM contracting officers to prepare for the eventuality of a performance failure require improvement. Consequently, the emphasis in the remainder of this chapter is placed on weaknesses noted in these early phases of the acquisition cycle.

Second, evidence gathered during this research indicates that there is a definite pattern to contracts which are ultimately terminated for default within DARCOM. Figure 10 presents summary level data to support this conclusion.

FIGURE 10

Data on Defaulting Contracts

Total Contracts Reviewed	Contract Type		Placement Method				Business Size		
	FFP	Other	FAD	SBRAD	Other	N/A	Small	Large	N/A
59	58	1	15	31	9	4	57	1	1

LEGEND: FFP = Firm Fixed Price
FAD = Formal Advertising
SBRAD = Small Business Restricted Advertising
N/A = Not Available for Review

The above statistics indicate that the vast majority of default terminations effected by DARCOM Readiness Commands involve firm fixed price contracts placed with small business firms by means of either formal or small business restricted advertising. The 59 default terminations covered by these statistics are considered to be representative of recent DARCOM experience in this area. With regard to FY 77 and 78 actions, the DD Form 350 sample included a total of 117 "termination or cancellation" actions. Command input indicated that only 19 of these actions represented terminations for default. Assuming that all "terminations or cancellations" were accurately reported, this figure represents the total population of default terminations of contracts in excess of \$10,000 for the two fiscal years surveyed.³³ Sixteen of these actions were reviewed, and the results are reflected in Figure 10. It should also be noted that DD Form 350 data was available for the remaining three actions. This data reflected that each was a firm fixed price contract with a small business; two were formally advertised, and one was a small business set aside. With regard to FY 79 actions, the Commands were requested to identify all default terminations effected through May 1979. Thirty-six actions were identified, of which seventeen were reviewed. Seventeen of the remaining actions involved the

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As previously noted, the actions of two commands were reduced by means of systematic sampling. This resulted in a total of 64 actions for which no information was solicited from the commands. However, by applying the same ratio of default terminations to total actions as was reflected in the sample to these 64 actions, it is projected that only 8 default terminations were excluded as a result of sampling.

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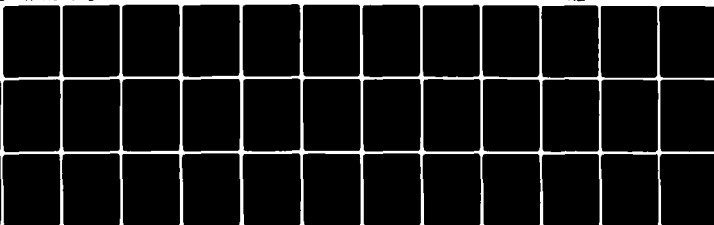
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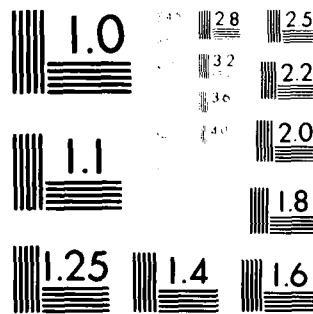
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termination of unilateral purchase orders of less than \$10,000 in value. Exclusion of these actions maintains parallelism with the FY 77/78 data, as such terminations would not require DD Form 350 reporting. The remaining two actions were not reviewed due to time constraints. Finally, a total of 26 additional actions were identified in the course of on site research. These were a mixture of (1) FY 79 actions taken after May 1979; (2) FY 77/78 actions under \$10,000 for which no DD Form 350 reporting was required; and (3) FY 77/78 actions for which no DD Form 350 reporting was accomplished for other reasons. In view of the above, the population reflected in Figure 10 is considered to closely approximate the total DARCOM experience in default terminations for the period under study. The only caveat to this assertion is to reemphasize the fact that purchase orders of less than \$10,000 are generally excluded.

The high incidence of firm fixed price contracts confirmed the traditional wisdom in this regard. The application of a fixed price contract presupposes a definitive baseline for performance measurement. Assuming that the Government fulfills its contractual obligations, total risk for success or failure is allocated to the contractor. It logically follows that terminations for default are a more viable possibility in such a definitive contractual environment. The fact that advertised placement is so prevalent is more difficult to explain. Data extracted from the Department of the Army Procurement Statistics for the period of 1 October 1976 through 31 March 1979, reflects that only 10.15% of contracts issued by DARCOM were placed by formal advertising or under the exceptions for small business set

asides. However, data collected for this study indicates that 83.6% of default terminations taken during a similar period were placed by these methods. The reasons for this disparity are not readily apparent.

The explanation may lie in an inherent characteristic of advertised procurement. That is, a competitive strategy envisions only limited, formal communication between buyer and seller prior to award. Such limited communication provides little opportunity to resolve misunderstandings which may ultimately lead to performance failures. Nevertheless, while this characteristic may well contribute to an increased default probability, it is not considered to be the primary cause. In fact, it is believed that no direct causal relationship exists. A more plausible explanation lies in two outcomes which are encouraged by advertised procurements. The first is the "buy-in" proposal. This practice is not unique to formal advertising, but a system which relies entirely on price competition increases the likelihood of its occurrence. The second contributing factor is the increased probability of award to a small business. The "open market" philosophy of formal advertising, coupled with a source selection process which requires that offerors meet only minimum standards of responsibility, contributes to contracting with small firms. In the case of small business restricted

This figure is somewhat different than the traditional methods of comparative analysis in that contracts which were negotiated under the authority of DAR 3-203, Purchases Not More Than \$10,000, are included.

advertising, of course, participation is limited to small firms. The potential problems associated with small business placement are discussed below.

The fact that small business concerns make up such a high proportion of defaulting contractors deserves special attention. Various opinions as to the reasons for this distribution were advanced by the individuals interviewed in the course of the study. For example, various contracting officers noted that they must often deal with a narrow base of large business producers on a repetitive basis. They asserted that default termination for an isolated performance failure is not feasible in such an environment, due to the ill will created with a necessary and normally reliable firm. In the extreme, a valuable producer might be driven from the market. Others frankly admitted the political influence which can be brought to bear by major companies. However, the most prominent reasons cited were as follows. Small business firms generally possess less technical expertise than larger firms, which results in lesser problem solving ability. More importantly, small businesses are often thinly capitalized. While the SBA loan program provides needed debt capital, tight monetary policies may adversely impact this program. As a result of cash flow problems, even if problem solving expertise does exist, the ability to absorb any losses which result from technical difficulties is very limited. Thus, while contractors of any size may encounter performance problems, the severity of their impact is much more acute in the case of a small business. The evidence gathered in the course of this research lends credence to this theory, as thirty of the small business defaults included in the data base stemmed directly from financial problems. The problem can be further

compounded by the "domino effect," whereby difficulty on one contract, coupled with limited financial resources, results in the inability to continue performance on other active contracts. In summary, larger companies may, in fact, possess the competitive or political leverage to resist default termination. However, it is felt that their greater human and financial resources often serve to reduce the severe impact of performance difficulties, thus forestalling default termination.

With this background, the following sections will turn to a more detailed analysis of current procedures in relation to the prescriptive model.

B. Contract Strategy Formulation.

With regard to the utilization of criticality indicators, the contract files reviewed in the course of this research did not reflect the systematic prioritization of contract management resources on the basis of either requirement urgency or dollar amount. It should be noted that the terminated contracts in the sample population were generally of a relatively low dollar value. Such files might be expected to include rather minimal documentation based on this criteria alone. However, many of the requirements reflected a level "A" Criticality Designator. As emphasized above, both of these parameters must be weighed in determining the appropriate level of contract management to be applied. At present, no effective prioritization of resources is evident.

The effective use of predictive indicators was similarly lacking. There was no evidence of historical analyses of the success or failure of applying price competitive strategies to previous buys. Apparently,

no data base exists for this purpose. Consequently, any historical insights are provided by the contracting officer's experience with the item in question. This informal methodology may be effective in some instances. However, its validity is questionable in view of the frequent personnel rotations noted during the reviews. Further, no effective mechanism for analyzing current market conditions was evident. Again, this may be accomplished informally, but there is apparently no systematic approach. Finally, in no case was there any indication that specification adequacy had been independently reviewed and verified. This could be assumed to be reflective of excellence in technical data packages. However, approval of waivers or deviations preceded nine default terminations in the data base. Further, specification deficiencies led to no cost cancellations in three additional cases. Had these deficiencies been corrected, satisfactory performance might have resulted. If performance failure resulted despite correction of the specification deficiencies, an element of Government culpability would have been removed, and termination for default might have been possible. In either case, the Government's interests would have been better protected. A need for improvement in this regard is indicated. In summary, there is little evidence of a systematic approach to the identification or utilization of predictive indicators during early planning phases of the process.

This general absence of early analysis and planning leads directly to two specific shortcomings. First, contracting officers have little visibility of potential problems and are unable to tailor their solicitations accordingly. Inclusion of special reporting requirements was infrequent

and inconsistent. As briefly alluded to above, pre-delivery milestone reporting has occasionally been used as a contractual vehicle for attaining early visibility of contractor progress. However, in the cases reviewed, such reporting was incorporated into the contract during performance as consideration for the relaxation of other requirements. Nevertheless, the technique offers promise for increased application during contract strategy formulation. The contract files reflected a similar absence of the inclusion of special responsibility requirements in solicitation documents. It is once again emphasized that such requirements cannot be unduly restrictive of competition. However, if judiciously applied, the utilization of special responsibility requirements may be advisable for complex items which require specialized expertise, facilities or equipment.

A second outgrowth of incomplete planning was evidenced by the lack of early coordination with other functional elements. This does not need to be a formal procedure in every instance. Again, this may currently be accomplished informally, but the files reflected no documentation of such efforts. It is obviously advantageous to know one's functional counterparts. This is particularly important in accomplishing contingency planning when the contracting officer's analysis casts doubt on the successful acquisition of an urgent requirement. However, neither predictive nor criticality indicators are evidently being utilized consistently in this regard.

It is felt that the deficiencies outlined above are indirectly attributable to the personnel resource limitations being experienced by the commands. Much of the available manpower is consumed in the obligation

of funds. Pressures associated with obligation responsibilities are such that few residual manhours are available for thorough planning. The negative effect of current manpower levels is a recurrent theme of this report. It is first manifest during the initial planning phase, but it is evident throughout the contract management cycle. Frequent rotation of contracting officers also compounds the problem. In the absence of additional personnel resources, coupled with a revised management emphasis, some of the improvements recommended by this study may not be possible. Increased utilization of automated data processing equipment (ADPE) offers some hope of alleviating the expenditure of manhours on repetitive tasks. For example, when fully implemented, the Procurement Automated Document Data System (PADDS) should relieve some of the burden of solicitation preparation and allow more time for thorough planning. Nevertheless, an overall increase in personnel ceilings may be required.

C. Source Selection.

The first problem noted in this phase concerns the identification of "buy-in" proposals. There is apparently no standard for isolating such bids. Bid abstracts were available for 39 of the contracts which were ultimately terminated for default. Only three of these files indicated overtly that a "buy-in" was suspected. However, closer scrutiny of the contract files revealed price differentials which were felt to warrant the classification of eleven additional bids as "buy-ins." Both conclusions were necessarily judgmental. The resulting disparity illustrates the inconsistencies that can occur when this aspect of Source Selection is left to subjective evaluation. A more objective standard is needed. This could

be based on a percentage differential from either the Government estimate or from the mean of other bids. As previously noted, 30 of 59 default terminations reviewed stemmed directly from financial insolvency. Given this pattern, increased sophistication in the identification and investigation of "buy-ins" is needed. This will either preclude award or identify the resultant contract for intensive management application.

With regard to the effectiveness of the contracting officer's responsibility determinations, several weaknesses were noted.

The most critical shortcoming regards the Government's ability to effectively analyze the prospective contractor's financial condition. Of the 30 default terminations resulting from financial insolvency, pre-award surveys were available for 24 contracts. In no instances was other than "complete award" recommended. However, in nine of these cases, review of the survey data indicated that financial problems were evident at the outset. Such factors as the current and acid test ratios were marginal or unacceptable. Cash flow problems and a pattern of loss were present. The above facts can lead to two conclusions. Both are considered valid, to a certain extent.

First, it could be concluded that the financial data which is currently relied on is inadequate. Referring back to the 24 surveys discussed above, even if the nine which were considered marginal by the researchers are deducted, 15 cases remain in which no adverse indicators were present. One explanation for this lies in the fact that current regulations do not require the submission of certified financial statements for review. Uncertified statements can obviously be overly optimistic and/or

self-serving. Interviews with DCAS analysts revealed a particular problem with regard to inflated inventory valuations. A partial answer to this problem is to compare interim statements with year end statements. The latter do require independent certification, and any gross variances should trigger further investigation. However, the timing of the survey request may make meaningful comparisons difficult.

A second possible conclusion would be that the current analysis techniques do not adequately differentiate between marginal and solvent firms. This may be largely the result of deficient data. However, it was discovered that present techniques rely on analysis of key information from the current financial statements only. Historical trend analysis is performed only when marginality is reflected on the face of the current statement. It is felt that a more comprehensive review of historical data would be most beneficial in identifying adverse trends. Such trends could then be projected into future periods in order to predict the firms financial posture throughout the life of the contract. Increased ADPE utilization is also indicated. A detailed discussion of some promising ADPE techniques is reserved for Chapter IV of this report.

In sum, the area of projecting financial capability is one of the major problem areas identified by this study. An aggressive effort toward improvement is definitely in order. Two actions intended to facilitate improvements within DARCOM are recommended under section B.2.a. in Chapter IV of this study.

Two final points regarding pre-award surveys are in order. First, it has long been recognized that improvement is necessary in the use of past

performance data in the Source Selection process. At present, while DCAS comments concerning a prospective contractor's performance record are normally included in pre-award surveys, there is apparently no effective means of incorporating such considerations into responsibility determinations. It is felt that advances in data storage and retrieval capabilities provide the means of utilizing such data in the future. This is considered to be a prime area for further study; a suggested approach is included in Chapter IV of this report. Finally, a weakness was alleged in the ability of DCAS to project the impact of multiple awards on the contractor's future capacity. Various contracting officers felt that DCAS reviews each potential award in a vacuum, without giving due consideration to the probability of the contractor receiving awards on other outstanding proposals. If the contractor is "too successful," multiple awards can place a strain on both its financial and manufacturing resources. The cognizant DCAS office is the only source of information in this regard due to its multi-service orientation. Consequently, impetus for improvement must come from that organization. However, as pointed out by DCAS, it is difficult to recommend no award simply because a contractor has bid on other work and may be awarded some or all of it. From that perspective, a potential award is reviewed independently, but not "in a vacuum." This is a difficult problem. Suffice to say that this type of information should be solicited from DCAS and analyzed carefully. In questionable situations, the contracting officer would be well advised to telephonically update the contractor's status just prior to award.

In a closely related area, there was a total absence of COC requests in the population of contracts reviewed, despite the fact that 58 of 59

actions involved small business contractors. This could be due to the fact that pre-award surveys are overly optimistic in their evaluation of contractor's responsibility. There is some evidence to support this contention. Pre-award surveys were available for 42 contracts, and only one recommended less than full award.³⁵ However, the contracting officer has a responsibility to independently analyze the factual data supporting the DCAS recommendation. In 12 cases, an independent review by the researchers revealed various elements of marginal responsibility. Had such an in-depth review been conducted upon receipt of the survey, SBA could have been advised of the contracting officer's intent to make a nonresponsibility determination. This, in turn, would have provided an opportunity for COC procedures to be initiated. The results of such initiatives are entirely speculative, but had this step been taken, 12 default terminations might have been avoided. At the very least, the contracting officer would have fulfilled his obligation to exhaust all reasonably available information regarding the firm's ability to perform. As previously noted, a COC request also serves the purpose of alerting the SBA to the contracting officer's specific concerns, so that appropriate assistance can be provided.³⁶

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It should be noted that comments by DCAS Headquarters personnel indicated that approximately 30% of all PAS's result in negative recommendations. While no attempt was made to verify this percentage, there is no reason to doubt its validity. Consequently, the results of this study may not reflect the historical average in this regard.

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A research paper was recently completed for the Florida Institute of Technology, entitled, "A Review of the Small Business Administration Certificate of Competency Program." Based on a review of the total number of COC's issued from FY 70 through FY 79, it was determined that only 5.5% of COC awards were terminated for default.

Two additional aspects of Contract Strategy Formulation deserve attention. They each fall under the general area of contract construction. First the utilization of a firm fixed price contract was questionable in only one of the 58 actions reviewed (the circumstances surrounding this case are discussed under section E.3, below). Second, in no case was the advertised placement of the contract questioned by the researchers. These observations, coupled with the general pattern of specification adequacy alluded to under section B, above, have led the researchers to conclude that most defaults result not from poorly constructed contracts, but rather from poorly performing contractors. In order to effect significant improvements, a key step is to augment our ability to distinguish between high risk and low risk contractors either before award or during the early stages of performance. The ability to make this distinction before award is the function of the contracting officer's responsibility determination. In order to improve decision making in this regard, the contracting officer must have better information and better analytical techniques at his disposal. The ability to identify high risk producers subsequent to award is a function of Contract Management Application as discussed below.

D. Contract Management Application.

In essence, most contracts under DARCOM cognizance appear to receive only exception management. This was reflected in the contract files reviewed as well as in interviews with various contracting officers. This, in turn, forces the contracting officer into a reactive rather than an active mode of performance management. Personnel limitations, coupled with top management emphasis on the timely obligation of funds, precludes effective post-award surveillance. Absent effective performance visibility, the contracting officer is unable to either implement corrective action

or pursue a default termination in advance of an actual delivery failure.

Without an effective internal capability to measure performance, the commands are almost totally dependent on DCAS surveillance and reporting. However, no individually tailored delegation letters which conveyed re-requirement urgency, outlined areas of concern, or detailed special surveillance/reporting requirements were noted in the contract files. There was a similar absence of Post-Award Conference Records (DD Forms 1484) in the files. As a result, DCAS must independently prioritize application of its resources in a manner which may or may not agree with purchasing office desires. Whatever avenue is chosen, improved communication with DCAS is needed in this regard.

Even if it is assumed that DCAS's internal guidelines effectively prioritize resource commitment and identify crucial surveillance parameters, the availability of resources within DCAS is an area of concern. Like many Government agencies in an era of budget reductions, DCAS has been faced with a continuous lowering of personnel ceilings. This has led to a mode of operation whereby the industrial specialist focuses on contractor-rather than individual contract-surveillance. That is, individual contracts are assigned to industrial specialists only when frequent in-plant surveillance is required. This is known as Category I surveillance. For less critical contracts, Category 2 surveillance is applied. Under this system, procurement clerks perform administrative surveillance, with technical assistance provided by the industrial specialist only as required. The lowest priority contracts-unilateral purchase orders-receive Category 3 surveillance. For contracts in this category, no inquiry as to the status of performance is normally made until 30 days after the delivery date has passed. Since assuming this mode of operation in 1976, DCAS points out that the percentage

of contracts receiving some form of predelivery (Category 1 or 2) surveillance has increased from 55 to 75 percent. However, the percentage receiving regularly scheduled (Category 1) surveillance by an industrial specialist has actually decreased from 23 to five percent. While the cost effectiveness of these methods cannot be judged, it is clear that in-plant predelivery surveillance is now conducted on an exception basis in the majority of cases. The strength of the Quality Assurance function has also been both quantitatively and qualitatively reduced as a result of personnel cutbacks and downgrading actions. This depletes a primary source of information as to the contractor's technical progress. Further, even if a given contract is accorded a high surveillance priority, unless it is a major program it will not receive the dedicated attention of either an Industrial Specialist or a Quality Assurance Representative. Rather, itinerant personnel will be assigned. This can result in significant gaps between in-plant visits. In a similar vein, the detailed review requirements for progress payment requests are being reduced. This trend can be expected to continue, and there is even talk of automating the progress payment approval cycle. Consequently, a primary avenue for financial surveillance is also being deemphasized.

In view of the above, it is evident that DARCOM's ability to pursue terminations on the basis of Expectant Default is severely limited. In the extreme, the inability to react to an Actual Default within a reasonable forbearance period may result in waiver of rights and remedies.

E. Default Disposition.

This section begins with the identification of problems associated with Expectant and Actual Default Terminations, respectively. It concludes with a discussion of some general findings which are common to both.

1. Expectant Default: The basic problem associated with Expectant De-

fault is the general inability of DARCOM contracting officers to pursue them effectively. Only seven of 59 default terminations reviewed were based on failure to make progress. On the surface, this would not appear to be a bad average. However, one of the actions resulted from anticipatory repudiation, and the remaining six actions resulted from contractor bankruptcy. The files reflected no reliance on adverse indicators which surfaced prior to the actual repudiation or bankruptcy. Thus, the ability to identify and utilize adverse indicators has not been demonstrated. In short, the classification of these terminations as Expectant Defaults was determined by the timing of the contractor's financial difficulties rather than by excellence in contract management.

The relative absence of Expectant Default terminations can be attributed to three factors. First, as previously noted the Government has a heavy burden of proof in this regard. While there is some evidence of a relaxed standard, the burden of proof is still clearly on the Government. Further, a stigma may still persist from the previous ASBCA standard. The net result is that an Expectant Default termination is a difficult undertaking in the best administrative circumstances. However, DARCOM contracting officers do not operate under ideal conditions. This is the second major contributing factor. Due to the general reliance on exception management, the contracting officer is often unable to compile or analyze the factual data required to support an Expectant Default termination in a systematic manner. Finally, the stringent legal doctrines, together with limited performance visibility, lead directly to the third problem: the general hesitancy of contracting officers to pursue Expectant Default terminations. This attitudinal problem is a general concern which will be

raised again in ensuing paragraphs. However, it is particularly noticeable in the case of Expectant Defaults.

2. Actual Default: No major weaknesses were noted in this area. However, while the evidence is inconclusive, the subject of waiver deserves some comment. As noted above, the waiver period for each action is determined by the situation at hand. However, by applying a convention that 30 days of inaction would constitute waiver, fifteen actions exceeded the limitation. Ten of these actions involved bankruptcies, and the time lapse is attributable to awaiting the ultimate resolution of contractor's financial solvency. This is a discretionary area and the wisdom of deferring termination is speculative. In view of the fact that all ten eventually resulted in bankruptcy, no material harm resulted. The remaining five actions are more disturbing, as the period of inactivity could be construed as a waiver. Some action would have been advisable immediately upon delivery slippage. The prompt issuance of a show cause letter represents affirmative evidence that time is still of the essence, thus protecting the Government's rights and remedies. Once again, the evidence does not indicate a major problem. However, proper utilization of the performance management techniques advocated by this study should preclude such occurrences.

3. General Comments. With regard to the discretionary judgments made by DARCOM contracting officers in determining Default Disposition, no major problems were indicated. Of the 59 default terminations reviewed, one decision may have been questionable. This was a firm fixed price contract involving considerable development efforts. There was some evidence of Government redirection of effort and delays in design approval. Therefore,

an excusable delay may exist. It is understood that the action is under appeal, so the issue is not resolved. This appears to be a marginal situation, and a termination for convenience might have been more advisable. At worst, the contracting officer was merely overzealous in protecting the Government's rights. Secondly, as noted in Chapter I, 23 convenience terminations and 13 no cost cancellations were also reviewed. The objective of this effort was to determine if the performing contractors were, in fact, in a defaulting status at the time of termination. If so, the action was viewed as a lost opportunity to terminate for default, and causative factors were sought. Only two of the 23 terminations for convenience were considered questionable. One of these was delinquent at the time of termination. However, the contract file was devoid of documentation, and no conclusion could be reached as to whether an excusable delay existed. The other contract reflected technical difficulties with some degree of Government culpability. Therefore, the convenience termination may have been the contracting officer's only recourse under the circumstances. Finally, there was no basis to fault the contracting officer's judgment in any of the 13 no cost cancellations reviewed. In fact, several of these actions could well have been terminated for convenience in view of the fact that the Government contributed in some degree to the contractor's failure. Only aggressive action on the part of the contracting officer at the time of Default Disposition is considered to have avoided termination settlement costs. In summary, it can be deduced that DARCOM contracting officers are exercising sound judgment in determining to pursue a termination in lieu of default when the circumstances warrant such

action. However, in certain cases it was felt that more thorough efforts during Contract Management Application might have precluded Government culpability in the resultant default. This, in turn, would have left all options open to the contracting officer at the time of Default Disposition.

The question that remains unanswered with regard to Default Disposition is whether a significant number of delinquent contracts are being modified to provide schedule extensions when such action is not in the Government's interest. A data base was not readily available to make this type of review. However, some comments gleaned from contracting officer interviews can be offered. The reasons most often cited for opting for a schedule extension in lieu of termination parallel the considerations called for by DAR 8-602.3(a)(iii)(iv) and (v). As noted in Chapter 2, DAR 3-602.3(a)(iv) cautions the contracting officer to weigh the time required for Reprocurement Action against the time in which delivery could be obtained from the delinquent contractor. This is a logical tradeoff which must be analyzed in each case. The ultimate purpose of a default termination should not be to punish the delinquent contractor, but rather to obtain performance in the most timely manner possible. Adequate consideration should, of course, be sought for any schedule extension granted to the delinquent contractor. With regard to items (iii) and (v), the commands must often deal with a relatively narrow base of producers. Each could be considered essential to the Government procurement program (item (v)). Terminating a base producer may not only affect its ability to perform other current contracts, but its availability as a future contractor as well. In the extreme, no alternate source may be available

(item (iii)). These are certainly legitimate considerations. However, interviews with personnel other than contracting officers (i.e., legal and command representatives) reflected a general perception that there is a widespread hesitancy to terminate for default. It is felt that management emphasis on pursuing legitimate default terminations, together with additional training in this area, will go far toward insuring that no bias in favor of schedule extension exists.

One final point with regard to Default Disposition is offered for consideration. A number of lawyers interviewed in the course of this study asserted that there is an over-reliance on the office of counsel on the part of contracting officers. For example, it was alleged that contracting officers are frequently not abreast of basic legal doctrines and burden of proof standards. Misunderstanding of cure notice requirements was also cited as a problem. Finally, lack of expertise in factual data compilation was noted by counsel. DARCOM PI 8-602.3(b) is specific in allocating this responsibility to the contracting officer. However, various lawyers alleged that they are often relied upon to compile the case file in support of a termination action. There was no documentary evidence to either support or challenge these assertions. To the degree that they are valid, it is believed that each problem is largely attributable to the fact that terminations for default are generally isolated, non-repetitive actions. Contracting officers do not pursue such actions on a regular basis, and they simply become out of practice in executing their responsibilities. Nevertheless, while counsel has an important role in Default Disposition, the responsibility ultimately rests with the contracting

officer. This study advocates close coordination with the legal element, but this does not mean that contracting officer responsibilities should be abdicated. Each element has distinct responsibilities in pursuing default terminations, and teamwork is the key to success.

F. Reprocurement Action.

The information gathered in the course of this study revealed very few problems with respect to Reprocurement Actions. The procedures set forth in the prescriptive model were being followed in the cases reviewed. However, it should be emphasized that it is the assessment of reprocurement costs which normally triggers litigation. Therefore, contracting officers must carefully weigh and document all actions taken during this phase of the process. Several instances of appeal to the ASBCA were, in fact, noted. However, certain of these appeals never reached the ASBCA because a mutually agreeable monetary settlement was reached before the case was heard. While these settlements were significantly less than the amount of excess costs assessed, the procedure has certain merits. It avoids the cost and delay of litigation. Further, the settlement amount accrues directly to the command, rather than to the central finance office. However, those cases reviewed reflected judgemental settlements which were apparently based on the perceived probability of successful litigation. It is felt that a more objective approach to establishing a negotiation position is needed. A suggested methodology is set forth in Chapter IV of this study.

CHAPTER IV

CONCLUSIONS AND RECOMMENDATIONS

A. CONCLUSIONS.

One of the major objectives of this research was to determine if advance indicators of contractor default are available to the contracting officer. It has been concluded that several types of indicators become available at various phases of the acquisition cycle. These include criticality indicators, predictive indicators and performance indicators. What is needed is a methodology to orient contracting officers to recognize and utilize such indicators. The recommendations set forth below are designed to provide such an orientation in the context of the Prescriptive Model for Performance Management presented in Chapter II.

A second objective was to determine the magnitude of the problems being encountered within DARCOM with regard to defaulting contractors. In this area, no definitive conclusions could be reached. This is attributable to two factors. First, while considerable insight was gained as to default terminations which were actually pursued, little empirical evidence was available regarding lost opportunities to terminate for default. No data base is maintained to reflect the number of terminations which were not pursuable due to the waiver of Government rights. Similarly, there is no available information on the number of schedule extensions granted without adequate consideration. Unless these questions are answered, the magnitude of nonperformance problems will not be clearly defined. Second, the number of default terminations varied considerably among commands. This has led to the conclusion that the degree of nonperformance

problems likewise varies among commands, due to such factors as diverse technologies and market conditions. By extension, the need for improvement is not uniform throughout DARCOM.

Despite the above differences in magnitude, certain common shortcomings have been identified which impede performance management throughout DARCOM. These shortcomings are primarily concentrated in the Source Selection and Contract Management Application phases of the acquisition cycle. By improving the ability of DARCOM contracting officers to manage these aspects of the process, their effectiveness in pursuing legitimate default terminations will be enhanced. The following recommendations are concentrated on those areas.

B. RECOMMENDATIONS.

In view of the absence of a uniform need for improved default procedures throughout the commands, a twofold approach to implementing the following recommendations is endorsed. These recommendations fall into two groups with regard to the cost of implementation. Those included under paragraphs IV.B.1 and IV.B.2.c. are aimed at increasing the expertise and awareness of contracting personnel at all management levels. They are procedural in nature and should not require a significant commitment of additional resources. It is recommended that these improvements be adopted as soon as practicable by all commands. On the other hand, the recommendations set forth under paragraphs IV.B.2. a and b. are more substantive and would require substantial commitments of both personnel and data processing resources. It is felt that such a commitment should be reserved to local management discretion, based on the perceived need for improvement in this area. Rules of thumb might be adopted as to an acceptable level of

contractual delinquencies (e.g., ten percent); if a trend exceeding that level became apparent, full implementation could be effected. Similarly, if problems are encountered primarily with small business contracts - as the results of this study would indicate - the recommended system could be selectively applied to those actions. The need for cost effective application has been stressed throughout this study. This approach would provide substantial improvements in basic procedures, while reserving local discretion with regard to the full implementation of intensive management techniques.

1. GENERAL RECOMMENDATIONS.

The opinion was repeatedly voiced during the interview phase of this research that DARCOM management had little interest in performance management or default terminations due to a preoccupation with funds obligations. Some individuals went so far as to question whether management would support a contracting officer who initiated a termination for default. Whether or not such opinions are justified, they reflect a widespread perception at the working level. In view of this perception, the catalyst for improvement must be provided by top management. Specific recommendations for improvement are set forth below. However, in the absence of a firm management commitment, few meaningful improvements can be realized.

One area which top management must emphasize is improved communications among the various functional elements which contribute to the performance management process. For example, communication between the contracting officer and the item manager is particularly important during the first four phases of the process. Coordination among contracting officers who do business with the same firm can provide insight as to current and past performance. This will be most useful during the Source Selection phase.

Similarly, a good working relationship with the Administrative Contracting Officer is essential during performance. Finally, close coordination with counsel is necessary in the areas of Default Disposition and Reprocurement Action. The contracting officer must serve as the team leader and ultimate decisionmaker. However, he must have reliable and timely information upon which to base a decision. Communication is the key.

A second general area which should be emphasized is additional training for contracting personnel. A review of default termination training offered by the Army Logistics Management Center (ALMC), indicates that three hours of instruction are included in both the Management of Defense Acquisition Contracts Course and the Management of Defense Acquisition Contracts Course (Advanced). This level of formal instruction is considered adequate with regard to Default Disposition and Reprocurement Action. However, it provides little coverage of the actions which should be taken during the earlier phases of performance management, and formal training is received only once or twice in an individual's career. As previously noted, default terminations are relatively isolated events, and there is a tendency to become unfamiliar with proper procedures. It is, therefore, recommended that Chapter II of this report be widely distributed to provide a ready reference as to basic doctrines and procedures. In addition, the model can be used as a vehicle for conducting periodic seminars. One day sessions are envisioned in which experiences could be shared and the model could be supplemented to include indicators which are unique to a given command. Such seminars would also provide the benefit of increasing sensitivity among affected personnel and providing the proper orientation for performance management. The office of counsel should participate in these

sessions in order to advise contracting personnel of new developments and doctrinal changes in the subject area. Legal participation will also foster improved communication between the functions as specific problems arise. It is also suggested that such periodicals as "Government Contracts Service," published by Procurement Associates, Inc., and "Government Contracts Reporter," published by Commerce Clearing House, be widely distributed for review by contracting personnel. These publications frequently synopsise important cases concerning terminations for default and can be of great value in keeping abreast of current developments in the subject area.

As a final improvement to the overall system, the frequency of contracting officer rotation should be minimized. In order for the methods prescribed by this study to be effective, continuity should be maintained throughout the cycle. It is recognized that personnel rotations cannot be eliminated, but proper management planning can minimize the problem.

2. SPECIFIC RECOMMENDATIONS.

Relatively minor recommendations for process improvement are implied throughout the Prescriptive Model for Performance Management. Application of the systematic approach advocated by the model will effect these improvements as a matter of course, and there is no need to reiterate each recommendation here. The recommendations set forth below are more substantive and may not be discernable on the face of the model. For ease of reference, they are presented in the context of the specific decision point to which they apply.

a. Source Selection.

(1) Establish standardized, quantified criteria for the identification of apparent "buy-in" offers. A percentile deviation below

the Government estimate is suggested. Alternately, a deviation below the mean of the bids received could be utilized. In view of the diversity of commodities throughout DARCOM, it is recommended that specific criteria be developed by the individual commands. For example, a given command may deal with a wide base of experienced producers which all employ a common technology. In this case, a rather minor percentile deviation might well trigger suspicion of a "buy-in" bid. However, another command may deal with a more volatile production base which would anticipate a broader distribution of bid prices. Consequently, a rather large deviation factor might be appropriate. Local discretion in this regard is, therefore, considered advisable.

(2) Establish an internal financial analysis capability. Such a capability is needed to analyze the financial conditions of firms submitting offers of less than \$25,000.³⁷ It could also be effective in independently reviewing the financial data reflected in pre-award surveys. This may be viewed as duplicating DCAS efforts. However, in view of the number of defaults resulting from financial insolvency, an independent review of financial indicators is considered necessary. It is suggested that the pricing elements of the various commands be assigned this responsibility.

(3) In a closely related area, it is recommended that alternative methods of financial analysis be explored. During the interview phase of this research, the DCAS financial analysts suggested that procedures

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As noted in Chapter 2, DAR 1-905.4 provides that a pre-award survey should not normally be requested on actions of less than \$25,000 in value.

employed by lending institutions in judging credit applications should be considered. While time did not permit a thorough investigation of all aspects of these procedures, one technique which is utilized is a form of multiple discriminate analysis (MDA). In essence, MDA is a statistical technique which attempts to distinguish between two (or more) mutually exclusive groups by means of the combinative effect of characteristics exhibited by those groups. In this case, the two groups would be projected bankruptcies and projected nonbankruptcies. In order to distinguish between these groups, it is necessary to identify a collection of "discriminating variables" which measure characteristics on which the groups differ. In this case, the discriminating variables would be the financial characteristics of the firms making up the two groups. The objective of MDA is to select, weight, and linearly combine the most significant variables so that the groups are as statistically distinct as possible. Data from historical cases is analyzed to determine that combination of characteristics (i.e., variables) which best discriminates between the groups. Once a set of variables is found which provides satisfactory discrimination for historical cases, a set of functions can be derived which will permit predictive classification of new cases into one group or another.³⁸ The Air Force Systems Command (AFSC) has developed a unified methodology for evaluating major Air Force contractors entitled Financial Capability Analysis (FINCAP). An integral part of the FINCAP methodology is the FINANDAS computer system

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Norman H. Nie, et al., Statistical Package for the Social Sciences, 2nd ed. (New York: McGraw-Hill Book Co., 1975), pp 434-436.

which applies a form of discriminant analysis to responsibility evaluation based on the linear combination of five key financial ratios. The FINCAP methodology also contains various other analytical techniques which offer promise, such as the ability to project hypothetical financial statements for a firm based on certain probable and worst-case assumptions. However, full treatment of all aspects of FINCAP is not possible here. While the methodology has not been extensively tested, early results indicate that the Air Force has found it useful and effective. It has the advantage of being geared to personnel with little training in financial analysis and can be accessed through the Copper Impact terminal. As the pricing elements are primarily responsible for Copper Impact, they should similarly assume the lead in FINCAP analysis. Alternately, discussions could be held with DCAS to explore its utilization during the pre-award survey.

b. Contract Management Application.

Establish an internal suspense system keyed to criticality, predictive and passive performance indicators. In the interest of minimizing the impact on limited personnel resources, utilization of ADPE capabilities is recommended for this purpose. Significant information would have to be abstracted from appropriate pre-award and contractual documents. Certain basic information such as contract number, contractor identification and placement date would be included. In addition, the criticality indicators (Criticality Designator and dollar value) would be displayed. Standard codes would be provided for predictive indicators, as well as open data fields for necessary amplification. Finally, appropriate performance milestones (passive performance indicators) would be listed for monitoring purposes. A standard form could be developed to

abstract data and provide computer input. The computer output would be a tabular listing by contract number for each contracting officer. This could be updated on a periodic basis (e.g., monthly) to insure currency and to incorporate necessary changes. Interim updates could be posted manually. DCAS currently uses similar techniques to generate its Contract Administration and Production Administration Delinquency Reports. It is, therefore, suggested that DCAS be contacted to draw upon its experience in this area. The computer output would be invaluable to the contracting officer in effectively monitoring performance. Having periodic reminders of upcoming performance milestones will facilitate timely status checks. Adverse developments (i.e., milestone slippage) will be identified, and preparatory actions can be initiated for the eventuality of a Default Disposition decision. This recommendation is central to the improvement of performance management within DARCOM. Its importance cannot be overemphasized.

c. Reprocurement Action.

Develop a more sophisticated methodology for establishing a negotiation objective when settlement of reprocurement costs prior to litigation is to be pursued. As previously noted, steelemen are currently negotiated on a judgmental basis, based primarily on the attorney's perception of the probability of success in litigation. While counsel's opinion is an important consideration, other factors should play an equally important role in developing a negotiation objective. For instance, a present value analysis could be performed to calculate the benefit of an expedited settlement. An average cost of litigation could also be quantified. These two amounts would then be deducted from the excess reprocurement

costs otherwise due. This methodology would provide the initial negotiation objective. This objective could then be judgementally modified to accommodate such considerations as the probability of success in litigation. By applying such rational methods to the establishment of settlement parameters the negotiation process would become much more scientific.

C. FUTURE STUDY OPPORTUNITIES.

It has been asserted in other sections of this study that default terminations primarily result from poorly performing contractors, rather than poorly constructed contracts. In view of this observation, the importance of the contracting officer's responsibility determination cannot be over-emphasized. The following areas for additional research have been identified. Each offers an opportunity to decrease the likelihood of encountering performance problems within DARCOM.

1. The results of this study have reaffirmed the long recognized need for an effective system of past performance measurement. It is, therefore, recommended that a methodology be developed to analyze past performance and to incorporate the results into the contracting officer's responsibility determination. It is noted that APRO 705, Evaluation of Purchase Cost Factors, concluded that a history of reliance on Government technical assistance could be used as an element in determining the responsibility of a prospective contractor. In addition, a proposed system of past performance evaluation based on selected administrative, cost, schedule and performance parameters was set forth in an article in the Defense Systems Management Review.³⁹ While further study would be required,

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Colonel Michael A. Nassr, "Past Performance: An Essential Element in Source Selection," Defense Systems Management Review, Autumn 1978, pp. 7-14

both of these approaches offer promise. Recent advances in ADPE storage, retrieval and analytical capabilities could be applied to implement such a system once key parameters for performance measurement are identified. If successful, such a system would represent a significant advance in Government contracting. It is felt that the time is right to renew DARCOM's efforts in this regard.

2. Perhaps the most significant finding of this research was that default terminations within DARCOM almost exclusively involve small business contractors. The most pervasive cause of small business default was financial insolvency. Faced with this recurrent pattern, there are essentially two options available to DARCOM. First, it can avoid doing business with marginally solvent firms. This is considered to be the only feasible reaction in the short run, and its precepts are embodied in the Source Selection recommendations set forth above. However, in the long run it may be beneficial to consider a more innovative approach. This strategy envisions a revised policy in providing financial assistance to small business firms. The theory is that if all the benefits attendant to small business contracting (e.g., technical innovation) are to be realized, alternative methods of channeling needed capital to such firms must be found. SBA has traditionally concentrated on providing access to debt capital sources, primarily by means of its guaranteed loan program. However, it appears that the Federal Reserve Board's recent credit-tightening policies have had an acute impact on the ability of small businesses to obtain debt capital. Banks are more reluctant to loan money to small businesses, and frequently have tightened requirements for down payments, equity and collateral. It is in this area (i.e., in helping small businesses

obtain financing) that the SBA guaranteed loan program is effective. However, small businesses are now faced with paying as much as 18% interest on debt capital. They are consequently concerned with their ability to survive and prosper if they have to pay this much for capital. The reluctance of small businesses to incur such debts is evidenced by the fact that requests for SBA guaranteed loans are running from 25 to 50% below a year ago in many cities.⁴⁰ Obtaining venture equity capital is also cited as a continuing problem in times of economic uncertainty.⁴¹ In short, there is every indication that the financial solvency of small business concerns will be even more problematic in the near future. SBA has the mission of assisting firms in this regard, and meaningful improvements would require that agency's support and cooperation. DCAS could also provide meaningful insights in this area. It is, therefore, recommended that a joint working group be convened to study this problem. If successful, this approach would serve the common interests of DARCOM, SBA and small business contractors by shifting from a policy of risk avoidance to one of risk reduction.

3. As previously noted, it is felt that this study adequately addresses DARCOM's experience with contracts which have been terminated for default. However, there is another population of contracts which encounter performance problems, but are not terminated. By regulation, a default termination is appropriate only in certain situations. In practice, it is

⁴⁰ The Wall Street Journal, 22 January 1980.

⁴¹ Deane Carson, ed., The Vital Majority: Small Business in the American Economy (Washington: US Government Printing Office, 1973), p. 40.

used in yet more limited circumstances (i.e., almost exclusively in the case of small business nonperformances). The question which has not been answered is whether the alternatives to termination for default are adequately protecting the Government's interests. It is, therefore, suggested that a broader study of nonperformance alternatives be initiated. This would entail studying a population of contracts which encountered performance problems and were either (1) allowed to continue without corrective action or (2) allowed to continue under relaxed terms in return for some form of consideration to the Government. The alternative actions (or inactions) taken to deal with such performance problems would be analyzed. Innovative and effective alternatives to default termination would be identified and publicized for wider application. The study would have the corollary benefits of completely defining the magnitude of nonperformance problems being encountered within DARCOM, and indicating the need for fully implementing the specific recommendations set forth above.

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APPENDIX A

Default Indicator Checklist Contract Strategy Formulation

1. Criticality Indicators

A. Criticality Designator

- . A
- . B
- . C

B. Dollar Value

- . High
- . Low

2. Initial Predictive Indicators

A. Purchase History

- . First Price Competition
- . Previous Terminations for Default
- . Previous Terminations in lieu of Default
- . Previous Delinquency
- . Previous Schedule Extensions

B. Technical Data Package

- . Previous Requests for Waivers or Deviations
- . Patent Inadequacies

C. Market Conditions

- . Previous "Buy-Ins"
- . Current Instability
- . Current Noncompetitive Status
- . Current Depression

D. Other Predictive Indicators

Source Selection

3. Additional Predictive Indicators

A. Apparent "Buy-In" _____

B. Questionable Responsibility

. Certificate of Competency Required _____

. Financial Resources Marginal _____

. Capacity Marginal _____

. Current/Past Performance Unsatisfactory _____

. Perseverance/Integrity/Tenacity Questionable _____

. Other Factors Marginal _____

C. Other Predictive Indicators

Performance Management Application

4. Passive Performance Indicators

A. Interim Milestone Slippage _____

B. Terminal Milestone Slippage _____

5. Active Performance Indicators

A. Physical Progress

. Adverse Contractor Progress Reports _____

. Adverse DCAS Progress Reports _____

. Adverse COTR Reports _____

- . Request for Delivery Extension _____
- B. Technical Progress
 - . Requests for Waivers/Deviations _____
 - . Adverse DCAS Reports _____
 - . Adverse COTR Reports _____
- C. Financial Status
 - . Request for Upward Price Adjustment _____
 - . Request for Revised Payment Provisions _____
 - . ACO Report of Adverse Developments _____
 - . Bank Assignment _____
 - . Loss Ratio Application to Progress Payment Requests _____
 - . Revised Financial Statements _____
- D. Other Performance Indicators

APPENDIX B
STUDY TEAM COMPOSITION

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13. ABSTRACT The 'Default' clause provides the Government with the right to terminate a contract upon the occurrence of a performance failure. However, this right may be sacrificed if contracting officers do not have adequate visibility of contractor performance. The objectives of this study were to (1) identify advance indicators of unpending defaults, and (2) develop an improved methodology for default detection based on the systematic use of such indicators. (u) <u>METHODOLOGY.</u> The approach employed to achieve these objectives was to (1) review applicable legal and regulatory material; (2) analyze a broad sample of recent termination actions; and (3) interview individuals in both the contracting and legal fields. <u>SUMMARY AND CONCLUSIONS.</u> Advance indicators of contractor default are manifest in many forms. Such indicators can be categorized and incorporated into a system level model of the performance management process. Use of this model will enhance the contracting officer's ability to pursue and sustain a default termination in a more effective and timely manner.			

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